In the

Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-952

GROUP LIFE AND HEALTH INSURANCE COMPANY a/k/a BLUE SHIELD and/or BLUE CROSS-BLUE SHIELD OF TEXAS, WALGREEN TEXAS COMPANY, THE SOMMERS DRUG STORES COMPANY, RIEGER/MEDI-SAVE PHARMACIES, INC. d/b/a GIBSONS PHARMACY,

Petitioners,

v.

ROYAL DRUG COMPANY, INC. d/b/a ROYAL PHARMACY OF CASTLE HILLS and DISCO PRESCRIPTION PHARMACY, BLAUSER'S PHARMACY, INC., PARKERS PHARMACY, INC., CRAIG BELL d/b/a BELL PHARMACY, GEORGE STONE d/b/a OLMOS PHARMACY, HIGHLAND HILLS PHARMACY, INC., ECONDOSE SYSTEMS, INC. d/b/a MEDICAL CENTER PHARMACY, GUSTAVE HNCIR d/b/a TURNERS PHARMACISTS, CARLOS DIAZ d/b/a VALLEY VIEW PHARMACY, ALFRED SANGALLI d/b/a STAR DRUG STORE, BLANCO PHARMACY, INC., BLANCO SOUTHSIDE PHARMACY, INC., DAN PARADA d/b/a DAN'S PHARMACY, RODOLFO L. DAVILA, INC. d/b/a DAVILA PHARMACY, DELLMAR PHARMACIES, INC. d/b/a DELLMAR PHARMACY #4, RONG, INC. d/b/a ECONOMY PHARMACY #1, ZARZAMORA PHARMACY, INC., and WHITE CROSS PROFESSIONAL PHARMACY, INC. d/b/a WHITE CROSS #1 and d/b/a WHITE CROSS #4

Respondents.

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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OPINION BELOW

The opinion of the United States District Court for the Western District of Texas is annexed hereto as Appendix A ("App. A") and is reported at 415 F. Supp. 343. The opinion of the United States Court of Appeals for the Fifth Circuit is annexed hereto as Appendix B ("App. B") and is reported at 556 F. 2d 1375.

QUESTIONS PRESENTED

In their Petition, Petitioners have posed the following as the question for review:

> [W]hether the "business of insurance" includes direct contractual arrangements between an insurer and third parties to provide benefits owed to the insurer's policyholders when such contractual arrangements are required by the policy of insurance. Petition at 2.

Respondents respectfully submit that the global question articulated by Petitioners was not the question decided by the Fifth Circuit, does not reflect the substance of the Fifth Circuit's decisicn, and is not the question to be considered for review by this Court.

If review were considered necessary, there would be two questions for analysis. The first would be whether an insurance company's combining and conspiring with retail pharmacy chains to fix prices in the retail pharmaceutical industry constitutes the "business of insurance," where the price fixing agreement is not required by the insurance policy or by the State of Texas and is not considered part of the "business of insurance" by Texas. The second question would be whether retail pharmacy chains can avoid the Sherman Act's proscriptions by combining with an insurance company and utilizing it as an intermediary to eliminate price and other forms of competition in the retail pharmaceutical industry.

Despite Petitioners' assertion, Respondents are not challenging "direct contractual arrangements between an insurer and third parties to provide benefits owed to the insurer's policyholders." The Fifth Circuit expressly recognized that the particular activities challenged by Respondents *are not* "benefits owed to the insurer's policyholders" and *are not* "required by the policy of insurance." *See* App. B, at 15b (556 F. 2d at 1382). Respondents are challenging Petitioners' combination to eliminate price and other forms of competition in the retail pharmaceutical industry.

The Petitioners are asking this Court to grant blanket McCarran-Ferguson Act (McCarran Act) immunity to *all activities* that might be included in direct contractual arrangements between insurers and providers of benefits. The Fifth Circuit followed this Court's ruling in *S.E.C. vs. Nat'l Securities, Inc.*, 393 U.S. 453 (1969), and refused to grant blanket antitrust immunity. It followed the correct legal standard by analyzing each challenged activity to determine whether it was a part of the "business of insurance" and noted that "[anticompetitive practices] do not become clothed with McCarran Act protection simply because an insurance company has contracted to pay the provider for goods or services." App. B, at 23b (556 F. 2d at 1386).

GENERAL

The factual underpinnings of this cause are crucial to a determination concerning the McCarran Act's applicability as is graphically illustrated by Petitioners' first footnote, wherein Petitioners assert that "[t]he operative facts are *essentially uncontested* and are *fully* and *fairly* set forth in the District Court opinion." Petition at 3, n.1 (emphasis added). The patent fallacy of this statement must be underscored and will, in itself, largely explain the Fifth Circuit's reversal of the District Court's summary judgment for Petitioners. As a reading of the Fifth Circuit's opinion demonstrates, the Fifth Circuit rejected the District Court's construction of the facts after a thorough analysis of the record.

Due to the central importance of the facts to the McCarran Act issue, Respondents must discuss them at length and specifically indicate misstatements or overstatements of fact contained in the Petition. It is hoped that any initial displeasure felt by the Court with respect to Respondents'

criticizing Petitioners' factual representations or those of the District Court will be tempered by a very close scrutiny of the facts as found by the Fifth Circuit as compared with the differing factual representations of Petitioners and Respondents.

STATEMENT OF THE CASE

In 1969, Blue Shield began offering prescription drug insurance coverage in Texas. Contemporaneous to its making prescription drug insurance available, Blue Shield began entering into Participating Drug Pharmacy Agreements (The Pharmacy Agreement) with retail pharmacies. Petitioners claim that the "purpose" of The Pharmacy Agreement is merely "to provide benefits to the insureds under the [prescription drug insurance] policies." Petition at 3. The Fifth Circuit correctly rejected this contention and observed that "the Pharmacy Agreement goes beyond Blue Shield's obligations as an insurer." App. B, at 15b (556 F. 2d at 1382).

The Pharmacy Agreement is simply a price fixing agreement. Pursuant to its terms, the participating pharmacy agrees to charge as its retail sales price for all sales of prescription pharmaceuticals to Blue Shield's subscribers an amount equal to the pharmacy's acquisition cost for the particular drug plus a "professional dispensing fee of $2.00". Each of the "Participating Pharmacies" knows that his competitors who sign The Pharmacy Agreement will be charging the same prices and that concerted action with respect to retail sales prices is contemplated and invited.

The pharmacies that sign The Pharmacy Agreement can charge no more for their prescription drugs than the amount specified therein, regardless of the magnitude of a particular drug's acquisition cost. Thus, the participating pharmacy

is limited to a two dollar ($2.00) markup (the "professional dispensing fee") whether its actual acquisition cost for a particular drug is eight dollars ($8.00) or eighty dollars ($80.00). With respect to specialized and highly expensive pharmaceuticals, The Pharmacy Agreement can result in the pharmacy's being allowed a markup that will not even cover the interest on its investment in inventory.

The retail sales price, as fixed in The Pharmacy Agreement between Blue Shield and the Petitioner pharmacy chains, has been set at a level below that at which small independent pharmacies can profitably compete and conduct business. Only large, high volume chains that sell many items in addition to pharmaceuticals can afford to operate pursuant to The Pharmacy Agreement. Additionally, The Pharmacy Agreement fixes the retail sales price for pharmaceuticals at a level that eliminates the small independent pharmacies' one effective means for competing with the large chains — the provision of services. Signatories of The Pharmacy Agreement are limited to the same retail sales price whether they provide home deliveries, twenty-four (24) hour service, or no service at all. The price set by The Pharmacy Agreement is at a level that does not enable the small independent pharmacies to provide extra services. Thus, their ability to compete is effectively destroyed.

The Pharmacy Agreement eliminates price competition and competition in services as well and constitutes a per se violation of Section One of the Sherman Act, 15 U.S.C. § 1 (1970). Each of the Petitioner pharmacy chains has executed one or more Pharmacy Agreements and otherwise combined and conspired with Blue Shield, and with each other, to fix the retail sales prices for prescription pharmaceuticals.

Blue Shield's plan of operation contemplates the fixing of retail sales prices in the retail pharmaceutical industry

generally. The small independent pharmacies are given the choice of either signing the price fixing agreement or being eventually forced from business. In reality, the choice is no choice, since the result of their signing the price fixing agreement is also eventual elimination.

The coercion of the small independent pharmacies to sign the price fixing agreement is brought about by the Petitioners' conspiracy to effect a boycott by Blue Shield's subscribers of the non-signing pharmacies and by their conspiracy to foreclose such pharmacies from a substantial portion of the market. A pharmacy that refuses to sign the price fixing agreement is effectively foreclosed from making further pharmaceutical sales to Blue Shield's subscribers because Blue Shield's subscribers are coerced not to patronize the non-signer.

Coercion of the subscribers is two-pronged. First, the subscriber receives markedly reduced benefits if he patronizes a pharmacy that refuses to sign the price-fixing agreement. While he is required to pay only the two dollar ($2.00) drug deductible for each prescription filled by a "participating pharmacy," he must ultimately pay an amount representing twenty-five (25%) percent of a "reasonable charge" for the drug, as determined by Blue Shield, in addition to the two dollar ($2.00) drug deductible, for each prescription filled by a non-signing pharmacy. Thi[illegible] monetary penalty for patronizing a pharmacy that refuses to sign the price fixing agreement arises because Blue Shield will reimburse the subscriber only seventy-five percent (75%) of a "reasonable charge" for the drug, as determined by Blue Shield, less the two dollar ($2.00) drug deductible, when non-signing pharmacies are patronized. Deposition testimony revealed no studies by Blue Shield that would justify this differential in benefits.

Obviously, the differential in benefits is intended to coerce Blue Shield's policyholders not to patronize non-signing pharmacies in Texas and thereby to coerce such pharmacies to sign the price fixing agreement. This purpose of coercion is graphically illustrated by the fact that under Blue Shield's prescription drug insurance "program", the subscriber will be reimbursed *100% of a "reasonable charge"* for the drug, less the two dollar ($2.00) drug deductible, *when he patronizes a non-signing pharmacy outside the State of Texas.* There could be no reason for distinguishing between non-signing pharmacies inside Texas and those outside the State, other than the fact that coercion of the latter would serve no useful purpose for Blue Shield.

There is a second and much more subtle step to the coercion. If a subscriber patronizes a participating pharmacy, the pharmacy is reimbursed directly by Blue Shield in the amount of its acquisition cost for the drug, and the subscriber is obligated to personally pay the pharmacy at the time of purchase only the two dollar ($2.00) drug deductible (in effect, the "professional dispensing fee"). However, when a pharmacy refuses to sign the price fixing agreement, Blue Shield refuses to deal with the pharmacy directly, and the subscriber must pay the entire retail sales price at the time of purchase rather than merely the two dollar ($2.00) deductible that he pays a Participating Pharmacy. After paying the entire sales price at the time of purchase, he must file a claim with Blue Shield seeking reimbursement (which will equal only seventy-five percent (75%) of a "reasonable charge" for the drug, as determined by Blue Shield, less the two dollar ($2.00) drug deductible).

The pressures exerted on the subscriber are obvious. That these pressures are aimed at coercing the subscribers not

to patronize the non-signing pharmacies, and thereby to coerce such pharmacies to sign the price fixing agreement, cannot be doubted. Whether the subscriber patronizes a signing or non-signing pharmacy, the same claim form is utilized; the same information is necessary to its completion; and the pharmacist's assistance is needed in providing this information. Significantly, the claim form itself directs the insured *to have the non-participating pharmacy* complete the prescription information section. Thus, since the pharmacy must participate in claims administration in both instances, no purpose is served by Blue Shield's refusal to deal directly with non-participating pharmacies other than to coerce them through the harassment of its policyholders. When the policyholder files his own claim, it is more involved for him than if he had patronized a participating pharmacy who would file the claim for him, and he must await reimbursement.

It is a rare subscriber indeed who is willing to accept reduced benefits and to undergo the administrative burden in order to patronize the pharmacy of his choice. Since the Prescription Drug Insurance Policy confers far more benefits on him when he patronizes a Participating Pharmacy than it does when he patronizes one that has refused to sign the price fixing agreement, he is subtly, but actually, coerced to purchase pharmaceuticals solely from Participating Pharmacies. The effectiveness of this coercion cannot be doubted. Of the 31,000 prescription claims per month processed by Blue Shield in late 1975, *only 1.9%* represented prescriptions filled by non-participating pharmacies. Thus, through the above mentioned methods of coercion, the Petitioners have effectively allocated to the signatories of the price fixing agreement virtually all sales of prescription pharmaceuticals to Blue Shield's subscribers. The coercion effectively fore-

closes the non-signing pharmacies from a substantial portion of the market and, therefore, constitutes an unreasonable restraint of trade in violation of Section 1 of the Sherman Act, 15 U.S.C. § 1 (1970).

The Petitioner pharmacy chains play a central role in the conspiracy to set the retail sales price of pharmaceuticals, the conspiracy to effect a boycott of Respondents, and the conspiracy to foreclose Respondents from a substantial portion of the market. It is only through the participation of the petitioner pharmacy chains that the small independent pharmacies can be whipsawed into agreeing to fix their retail sales prices. By combining with the petitioner pharmacy chains, who have many outlets, Blue Shield has guaranteed that its policyholders will not have to choose between geographical convenience and reduced policy benefits when deciding whether to patronize a non-signing pharmacy. The policyholder will generally find one of the petitioner pharmacy chains outlets to be readily accessible. The petitioner chains help guarantee that the sole factors in the policyholder's mind will be the markedly reduced policy benefits and administrative inconvenience that he will have to suffer if he patronizes a non-signing pharmacy.

Petitioners seek to avoid scrutiny of their activities under the Sherman Act by alleging that their conduct is merely the "business of insurance" and falls within the protective umbrella of the McCarran Act, 15 U.S.C. §§ 1011 *et seq.* (1970). They erroneously represent that their "*program* is regulated by the State of Texas," that "*permission* for its use has been obtained from the appropriate authorities", and that the Commissioner of Insurance "authorized" issuance and use of the prescription drug insurance policy form *and* The Pharmacy Agreement in the State of Texas. Petition at 4 (emphasis added).

Petitioners' representation that the Commissioner of Insurance authorized issuance and use of The Pharmacy Agreement is erroneous and has no foundation in fact. As the Fifth Circuit expressly stated, "[i]t is clear from the record that the Board [of Insurance] has never approved The Pharmacy Agreement." App. B, at 19b (556 F. 2d at 1384). The Pharmacy Agreement has never been approved, authorized, or regulated by the Board of Insurance. Nor has the Board ever purported to have authority to authorize or regulate The Pharmacy Agreement or Petitioners' price fixing conspiracy associated therewith. In addition, Texas does not regulate the rates charged for the coverage included here nor the reimbursements to pharmacies from insurers.

In stating that their "program" is regulated by the State of Texas and that permission for its use has been obtained from the appropriate authorities, Petitioners imply that all of their activities, including those challenged by Respondents, have been studied, considered, approved, or regulated by the "appropriate" authorities. In no instance was The Pharmacy Agreement and its attendant price fixing approved, authorized or in any manner treated as a part of the business of insurance in Texas. The Fifth Circuit rejected Petitioners' contentions in this regard after a careful reading of the various opinions, letters, and other documents emanating from the various officials and agencies of the State of Texas.

In their "Statement of the Case", Petitioners allege that Blue Shield has entered into The Pharmacy Agreement with pharmacies throughout the State of Texas "[i]n order to implement the benefits provisions of the policies." Petition at 4-5. As the Fifth Circuit concluded, The Pharmacy Agreement has little to do with "implementing the benefits pro-

visions" of Blue Shield's policies. The fixing of retail sales prices for pharmaceuticals and the coercion of pharmacies to fix their prices *are not* benefits owed to the insureds under the insurance contract. Indeed, Blue Shield's sole obligation is to see that *the insured* receives prescription drugs and "*shall be required to pay no more* than the drug deductible for each of such covered drugs." The conspiracy to fix prices is merely a profit-maximizing endeavor for Blue Shield's benefit.

Blue Shield is no more obligated to its policyholders to fix the retail sales prices of pharmaceuticals than an automobile insurer is obligated to its insureds having $100 deductible policies to fix the prices to be charged in the future by body shops for parts and labor. To call this activity the "implementation of policy benefits" is a veritable *tour de force.*

Petitioners have erroneously attributed to Respondents the following contention:

> [T]hat in contracting with pharmacies to provide the policy benefits to its insureds, Blue Shield is somehow not engaged in the "business of insurance" within the meaning of the McCarran Act. Petition at 5.

In no respect are Respondents making the contention attributed to them. The Pharmacy Agreements do much more than merely require the Participating Pharmacies to dispense covered pharmaceuticals to Blue Shield's insureds.

The Pharmacy Agreements serve as a vehicle by which competing pharmacies conspire and agree concerning the *total price* that *they will charge* for dispensing pharmaceuticals to Blue Shield's policyholders. By virtue of The Pharmacy Agreements' price fixing provision, Blue Shield and

the petitioner pharmacy chains are conspiring to eliminate price and other forms of competition in the retail pharmaceutical industry. It is these activities that Respondents contend do not constitute a part of the "business of insurance." As the Fifth Circuit noted:

> [I]t is not the office of the insurance industry to set the prices in the various sectors of our economy so that insurers will enjoy an added measure of control over the magnitude of individual claims. App. B, at 18b (556 F. 2d at 1384).

Throughout their Petition, Petitioners ignore the activities embraced by The Pharmacy Agreement. They discuss the Agreement in the abstract as an innocuous "direct contractual relationship between an insurer and the providers of benefits for the provision of policy benefits owed to the insureds."

On page 6 of their Petition, Petitioners make the following statement:

> Despite the District Court's findings that The Pharmacy Agreement is inextricably linked to and in fact required by the policy provisions relating to benefits and coverage, the Court of Appeals concluded that "Blue Shield's policyholders are basically unconcerned with the contract between the insurer and the Participating Pharmacy."

Petitioners conveniently take the Fifth Circuits' quoted language out of context and omit the important sentence that precedes it.

> It is unnecessary for Blue Shield to agree with pharmacies to fix retail sales prices in the pharmaceutical industry. App. B, at 12b (556 F. 2d at 1381).

Petitioners fail to point out that the Fifth Circuit *expressly rejected* the District Court's finding that The Pharmacy

Agreement "is inextricably linked to and in fact required by the policy provisions relating to benefits and coverage." The Fifth Circuit analyzed the particular activities embraced by the Agreement. It was this analysis which led the appellate court to conclude that "Blue Shield's policyholders are basically unconcerned with the contract".

The Fifth Circuit stripped The Pharmacy Agreement of its self-serving language concerning the provision of benefits and recognized it is nothing more than a price fixing agreement. It refused to pervert the McCarran Act's language beyond all reason and hold that the Petitioners' challenged activities constitute the "business of insurance." The Fifth Circuit correctly held as follows:

> [T]here is no . . . indication that the activities complained of are considered the business of insurance by the State *or by any common sense interpretation of that term.* App. B, at 21b (556 F. 2d at 1385) (emphasis added).

RESPONSE TO REASONS FOR GRANTING THE WRIT

I. The Fifth Circuit's Decision Does Not Conflict With The Decision of Any Other Court of Appeals.

Petitioners try to create a conflict between the Fifth Circuit's decision and the decisions of other courts of appeal with the following contention:

> The decision below stands alone and is in direct conflict with every other court of appeals decision which has had occasion to consider whether the "business of insurance" includes an insurer's dealings with third parties to *satisfy obligations due to its insureds.* Petition at 7 (emphasis added).

Although Petitioners endeavored to convince the Fifth Circuit that such issue was at the heart of the present controversy, the appellate court correctly recognized that the particular activities challenged by Respondents *are not* "dealings with third parties to satisfy obligations due . . . [Blue Shield's] insureds." Indeed, the essence of the Fifth Circuit's opinion is the following:

> We find that The Pharmacy Agreement goes beyond Blue Shield's obligations as an insurer and places the firm in the business of providing goods and services. Blue Shield has agreed to provide protection against the risk that a policyholder will require pharmaceuticals. In order to meet that obligation, Blue Shield is not required to guarantee the provision of services on a "cost plus" basis or any other basis which might be more economical than the retail purchase of such products. App. B, at 15b (556 F. 2d at 1382).

The Fifth Circuit's decision does not conflict with the decision of any other court of appeals. Neither the Third, the Fourth, nor the D. C. Circuits have held that "participating agreements" between insurers and providers of benefits are automatically and in all cases part of the "business of insurance." None of these courts held that any and all activities embraced by such "participating agreements" are part of the "business of insurance." Each of the decisions by these courts has turned on the specific facts of the case and on the specific activities being challenged. A close reading of the cases discloses facts and activities unlike those in this case.

The trilogy of cases decided by the Third Circuit began with *Travelers Ins. Co. v. Blue Cross of Western Pennsylvania*, 481 F. 2d 80 (3d Cir.), *cert. denied*, 414 U.S. 1093

(1973). The Fifth Circuit recognized that *Travelers* carries little precedential value in this appeal." App. B, at 176 (556 F. 2d at 1383). *Travelers* and its progeny, *Doctors, Inc. v. Blue Cross of Greater Philadelphia*, 1977-1 Trade Cas. ¶ 61,420, at 71,560 (3d Cir. 1977), *aff'g per curiam*, Civil Action No. 73-1057 (E.D. Pa. Aug. 13, 1975), and *Frankford Hospital v. Blue Cross of Greater Philadelphia*, 554 F. 2d 1253 (3d Cir.), *cert. denied*, ... U.S. ....., No. 77-171 (Oct. 3, 1977), involve a very special fact situation wholly unlike that in this case. These cases cannot be cited for the proposition that direct contractual relationships between insurers and the providers of benefits, which relate in some manner to the provisions of benefits, necessarily constitute the business of insurance with respect to all activities embraced by the agreements.

While *Travelers* involved a direct contractual relationship between an insurer and the providers of benefits, the similarity between that case and the present one ends with this single characteristic. The fact that there was a direct contractual relationship between Blue Cross and the providers of benefits, some non-profit hospitals, did not in itself serve as the basis for the Third Circuit's opinion. Only after one reads the District Court's opinion in *Travelers*, and thereby gains an understanding of the highly specialized facts in that case, can the true basis of the Third Circuit's opinion be understood. See, *Travelers Ins. Co. vs. Blue Cross*, 361 F. Supp. 774 (W.D. Pa. 1972), *aff'd*, 481 F. 2d 80 (3d Cir.), *cert. den.*, 414 U.S. 1093 (1973).

In *Doctors, Inc. v. Blue Cross*, Civil Action No. 73-1057 (E.D. Pa. Aug. 13, 1975), *aff'd per curiam*, 1977-1 Trade Cas. ¶61,420, at 71,560 (3d Cir. 1977), the Court correctly observed that the decision in *Travelers* was based on the specialized provisions of Pennsylvania law — provisions having no counterpart in Texas and that are totally alien to the facts of the present case. The Court in *Doctors, Inc.* correctly construed the narrowness of the Third Circuit's holding in *Travelers* as follows:

> It is therefore readily apparent from the reading of the *Travelers* case that *the Third Circuit is approving the actions of the Insurance Commissioner of Pennsylvania* when he exerts pressure on the large insurance companies to get them to exercise their power over hospitals to force the hospitals to cut costs wherever possible. *Id.* at 9 [emphasis added].

The fact that there was a direct contractual relationship between Blue Cross and the non-profit hospitals was not in itself important.

Of crucial importance to the *Travelers* opinion was the fact that Pennsylvania's legislature had chosen to control the rates charged by non-profit hospitals through a *statutorily* created interrelationship between the rates charged by non-profit health insurers and non-profit hospitals, which interrelationship was to be regulated by the Pennsylvania Insurance Department. As the District Court observed in *Travelers*:

> [T]he activities of Blue Cross in all respects material to this case, *including the terms of the contract under attack*, are regulated and *directed* by the Insurance Department of the Commonwealth of Pennsylvania in strict conformity with the provisions of the Nonprofit Hospital Plan Act of 1973 . . . . *Travelers Ins. Co. vs. Blue Cross*, 361 F. Supp. 774, 776 (W.D. Pa. 1972) [emphasis added].

Additionally, it observed the following with respect to Pennsylvania's Nonprofit Hospital Plan Act:

> "Under the terms of said act, Blue Cross having been previously organized under the Pennsylvania Nonprofit

> Corporation Law . . . for the purpose of establishing, maintaining and operating such a *non-profit hospital plan* became the subject of regulation by the Pennsylvania Insurance Department in the following respects:
>
> > 'the rates charged to subscribers . . ., *all rates of payments to hospitals . . ., and any and all contracts entered into . . . with any hospital.*' . . . *The Blue Cross Hospital contract is, therefore, an integral part of Pennsylvania's regulated hospital plan.*" *Id.* at 777 [emphasis added].

It can be seen, then, that the Pennsylvania legislature had chosen to indirectly control the rates charged by non-profit hospitals by charging the Insurance Department with the task of directing and controlling the terms of contracts between *non-profit* health insurers and *non-profit* hospitals and with controlling the rates of payments by non-profit insurers to non-profit hospitals.

The role of the Pennsylvania Insurance Department in determining the terms of Blue Cross' contracts with non-profit hospitals is very extensive as is shown in *Frankford Hospital vs. Blue Cross*, Civil Action No. 74-2281 (E.D. Pa. June 8, 1976), *aff'd per curiam*, 554 F. 2d 1253 (3rd Cir.), *cert. denied*, ... U.S. ....., No. 77-171 (Oct. 3, 1977). *Frankford* involved a challenge by a non-profit hospital to Blue Cross' contract with hospitals. The District Court relied on the *Travelers* opinion and stressed as follows:

> "Both the rates Blue Cross charges to subscribers and its rate of payments to hospitals must be approved in advance by the Insurance Department before they can go into effect. 40 Pa. C.S.A. § 6124. . . . The Department instructed Blue Cross to develop a uniform contract [with non-profit hospitals]. It particularly stressed that this contract should include the cost accounting principles upon which reimbursement under the federal Medicare Program was based." *Id.* at 3.

The Court noted that when Blue Cross first submitted its proposed uniform cost contract between itself and Philadelphia area hospitals, the contract was rejected by the Insurance Commissioner, who instructed Blue Cross that it was not to pay for any portion of the hospitals' unreimbursed outpatient cost or for costs of depreciation. The Commissioner viewed these costs as a "community responsibility, including federal, state and local governments as well as eleemosynary institutions . . ." *Id.* at 3-4.

Finally, the Hospital Agreement of 1971 was approved, "the terms of which reflected Commissioner Denenberg's negotiating guidelines." *Id.* at 5. When the 1971 Agreement expired in 1974, a number of hospitals refused to sign a new hospital agreement with Blue Cross, in response to which "the Commonwealth of Pennsylvania enacted Act No. 94 of 1975, (40 P.S. § 6124c). It reinstated, retroactively, the 1971 Hospital Agreement between Blue Cross and the non-member DVHC hospitals." *Id.* at 6. Considering this factual background, it is evident that the *Travelers* opinion in no sense conflicts with the Fifth Circuit's decision in the present controversy and certainly cannot be cited for the broad proposition that "participating agreements" between an insurer and a provider of benefits are *ipso facto* shielded by the McCarran Act from antitrust challenge. The mere fact that a conspiracy to fix prices is embodied in a "participating agreement" does not invoke McCarran Act immunity.

The Fifth Circuit expressly recognized that the Third Circuit's decisions were not in conflict with its holding. Petitioners have misconstrued the Fifth Circuit's reading of the Third Circuit's opinions and, in the process, have erroneously attributed to the Fifth Circuit the reasoning that

"unless there is state regulation, a company cannot be engaged in the "business of insurance." Petition at 10.

The Fifth Circuit did not employ the reasoning Petitioners attribute to it. Rather, its discussion concerning the role played by Pennsylvania's Insurance Commissioner and legislature in the execution of Blue Cross' "participating agreements" was intended to demonstrate that there was no conspiracy between Blue Cross and the participating hospitals to fix prices. In executing the agreements and in drafting their contents, Blue Cross was merely performing obligations that it owed to its insureds *by virtue of the unique features of Pennsylvania law*. Blue Cross was doing what Pennsylvania law *required* it to do in order to underwrite insurance *covering health care at non-profit hospitals*. The Third Circuit was not confronted with a conspiracy to fix prices in a private sector of the economy. Rather, it was confronted with an agreement that was the product of unique features of Pennsylvania law — an agreement that was ultimately enacted into law by the Pennsylvania legislature.

The Fifth Circuit contrasted the present controversy with the Third Circuit's cases by emphasizing that Blue Shield, in conspiring to fix the retail sales prices for pharmaceuticals, is not performing obligations that it owes its insureds under the insurance policy or under any aspect of Texas law. It recognized that Blue Shield is attempting to subvert free market competition in a private, non-insurance sector of our economy. Such activity is not the "business of insurance."

Another of the "conflicting" decisions cited by Petitioners is *Proctor v. State Farm Mut. Auto Ins. Co.*, 561 F. 2d 262 (D.C. Cir. 1977), *petition for cert. pending*, No. 77-580. *Proctor* cannot be cited for the proposition that all direct contractual arrangements between insurers and providers of

benefits are automatically a part of the "business of insurance." Rather, the D. C. Circuit emphasized that "[t]he question [whether an activity is part of the 'business of insurance'] is ultimately one of line-drawing, based on the facts of the individual case." *Id.* at 268. The D. C. Circuit cited the District Court's opinion in this case with approval, but did so prior to the Fifth Circuit's correcting the erroneous statements of fact on which the District Court's legal conclusions were premised. If it had been given the benefit of the facts as they actually exist, the D. C. Circuit most assuredly would not have cited the District Court's opinion with approval.

Proctor involves a challenge to a "horizontal agreement [among insurers] to pay or reimburse *their policyholders* according to a common formula." *Id.* at 264 (emphasis added). In essence, the case involves a challenge to insurers' conspiring among themselves concerning the maximum dollar amount of coverage the insurers will provide per claim for their insureds. The present cause, by contract, involves a challenge to a conspiracy between an insurer and retail pharmacy chains concerning the *retail prices to be charged by the retail pharmaceutical industry* for its goods and services. There is no indication that the D. C. Circuit would consider the latter activity to constitute the business of insurance.

Petitioners' reliance on *Anderson v. Medical Service of the District of Columbia*, 551 F. 2d 304 (4th Cir. 1977), *aff'g per curiam*, 5 Trade Reg. Rep. ¶60,884, at 68,855 (E.D. Va. 1976), to create a conflict with the Fifth Circuit's decision is also misplaced. Although *Anderson* did involve direct contractual relationships between an insurer and the providers of benefits, physicians, the opinion was not based on the

mere fact that the challenged activity was embodied in a direct contract between an insurer and the providers of benefits. The district court in *Anderson* stressed the fact that the challenged activity did not operate to fix prices. The court further stressed that the insureds were not coerced to patronize participating physicians and that policy benefits were the same whether the subscriber patronized a participating or non-participating physician. 5 Trade Reg. Rep. ¶60,884, at 68,857. The fact situation in *Anderson* differs markedly from that in this case where prices are fixed and Blue Shield's subscribers must pay a sizeable financial penalty in the form of markedly reduced policy benefits if they patronize non-participating pharmacies.

The absence of a conflict between the Fifth Circuit's opinion and those of the other courts of appeals perhaps is most graphically illustrated by Petitioners' own observation concerning the other courts' decisions —

> [T]he Courts of Appeals for the District of Columbia, Third and Fourth Circuits all have held that the satisfaction of obligations due the insured . . . is at the "core of the 'business of insurance'. . . . [Petition at 10].

The Fifth Circuit focused on the activities in question. It held that the particular activities challenged by Respondents are *not* obligations due the insureds and that Blue Shield is not obligated to fix the retail sales prices in the pharmaceutical industry. App. B, at 12b-15b (556 F. 2d at 1381-82).

Petitioners erroneously claim a conflict between the Fifth Circuit's opinion and opinions by the Third and Seventh Circuit's with respect to the Fifth Circuit's holding that the

petitioner pharmacy chains are not engaged in the business of insurance. *See* Petition at 10. Contrary to the impression Petitioners try to create, the Fifth Circuit did not hold that non-insurance company defendants can never qualify for McCarran Act protection. Rather, it held that the petitioner pharmacy chains, in selling pharmaceuticals and in conspiring to fix the retail sales prices of pharmaceuticals, are not engaged in the "business of insurance." Neither of these activities are activities classically performed by insurance companies.

Although the Seventh Circuit in *Lowe v. Aarco-American, Inc.*, 536 F. 2d 1160 (7th Cir. 1976), did cloak two non-insurance company defendants with McCarran Act immunity concerning alleged violations of the Truth in Lending Act, the holding of that case is much narrower than Petitioners imply. The defendants were an insurance broker and a premium finance company. They were sued for alleged violations of the Truth in Lending Act that allegedly occurred in their credit sales of insurance policies. The Seventh Circuit correctly held that the credit sales of insurance policies are part of the business of insurance and correctly invoked McCarran Act immunity. Although the two defendants in *Lowe* were not insurance companies, they were performing activities customarily performed by insurers. One defendant sold automobile insurance policies and the other defendant financed the premiums required under those policies. In this regard, they could be viewed as extensions of the insurance company. The Seventh Circuit expressly noted that Illinois regulates premium finance companies under the Illinois Insurance Code.

The Petitioner pharmacy chains herein, unlike the defendants in *Lowe*, are not performing activities customarily per-

formed by insurers. The fixing of prices in the pharmaceutical industry is not a customary activity of insurance companies, and the Petitioner pharmacy chains cannot by virtue of their price fixing activities be considered extensions of an insurance company. The Texas State Board of Insurance has no authority over pharmacies. Had the Petitioner pharmacy chains engaged in price fixing activities without Blue Shield's participation, there would be little question that a per se violation of the federal antitrust laws was committed. *See United States v. Utah Pharmaceutical Association*, 201 F. Supp. (D. Utah), *aff'd*, 371 U.S. 24 (1962). *Lowe* serves as no precedent for the extension of the McCarran Act to the activities of the Defendant pharmacy chains in conspiring and agreeing to fix prices.

Petitioners have misread the Third Circuit's holding in *Doctors, Inc. v. Blue Cross of Greater Philadelphia*, 1977-1 Trade Cas. ¶61,420, at 71,560 (3rd Cir. 1977). *aff'g per curiam*, Civil Action No. 73-1057 (E.D. Pa. 1975). Petitioners have alleged the following:

> In *Doctors, Inc., supra*, the Court of Appeals for the Third Circuit affirmed the District Court's dismissal of the complaint as to Blue Cross and a private non-participating health care and hospital advisory agency *found to be within the "business of insurance."* Petition at 10. (emphasis added).

Neither the trial nor the appellate court in *Doctors, Inc.* found the advisory agency to be within the "business of insurance". Indeed, not even the advisory agency itself claimed to be engaged in the "business of insurance".

The district court expressly noted that the advisory agency "has filed a motion for summary judgment *on the grounds that it was not a co-conspirator.*" Civil Action No. 73-1057 at 2 (emphasis added). In granting a summary

judgment for the advisory agency, the district court premised its action on the lack of a conspiracy, not on the advisory agency's being within the "business of insurance." In affirming the district court's opinion, the Third Circuit merely held that "the 'business of insurance' provisions of the McCarran-Ferguson Act remove *Blue Cross' conduct* here from coverage of the Sherman Act." 1977-1 Trade Cas. ¶ 6140, at 71,561 (emphasis added). *Doctor's, Inc.* in no sense holds that non-insurance company entities not engaged in activities classically performed by insurance companies can be engaged in the "business of insurance" for McCarran Act purposes.

II. The Fifth Circuit's Decision Does Not Jeopardize The Existence of Prepaid Health Insurance Plans and Will Not Preempt State Regulation of Health Insurance.

A. The Existence of Prepaid Health Insurance Plans

Petitioners pose the following sympathy evoking argument as a basis for this Court's granting a writ of certiorari:

> "By subjecting insurers' contracts with providers of health care services to the antitrust laws, even though such contracts are an inseparable feature of prepaid health insurance policies which are regulated by the states, the decision below threatens the viability of a new and growing segment of the health insurance industry." Petition at 11.

This argument is utterly fallacious and misleading.

The Fifth Circuit *did not* hold that all "insurers' contracts with providers of health care services" are *ipso facto* subject to the antitrust laws or that all activities embraced by such contracts are subject to antitrust scrutiny. Rather, the Fifth Circuit has held that *the particular activities challenged by Respondents* are subject to antitrust scrutiny

despite the fact that Petitioners have camouflaged such activities within contracts between Blue Shield and the Petitioner pharmacy chains.

Petitioners want this Court to expand application of the McCarran Act by granting blanket antitrust exemptions for any and all activities embraced by a contract between a health insurer and providers of benefits. Petitioners' "direct contract" argument is contrary to the McCarran Act. It would make antitrust immunity dependent on contractual arrangements entered into between an insurer and non-insurance parties, not on satisfaction of the McCarran Act requirements. It would mean that any direct contract with an insurer *ipso facto* would exempt all of the contracting parties from the federal antitrust laws, irrespective of whether the parties are engaged in the "business of insurance", as the McCarran Act requires. It thus creates an antitrust exemption not conferred by Congress. While this argument has the virtue of simplicity, it is patently invalid and finds no support in the McCarran Act. Activities do not become a part of the "business of insurance" merely because they are contemplated or embraced by a contract to which an insurer is a party.

A second fallacy of Petitioners' argument is its premise that the activities challenged by Respondents are "an inseparable feature of prepaid health policies which are regulated by the states." The Fifth Circuit correctly found that the price fixing and coercion practiced by Petitioners are *not* an inseparable feature of Blue Shield's health insurance policies, are not peculiar to the "business of insurance," and are not regulated by Texas as a part of the "business of insurance."

The setting of retail prices in the various private sectors of our economy certainly is not encompassed by the business

of insurance. As the Fifth Circuit correctly recognized, an insurer "is not required to guarantee the provision of services on a 'cost-plus' basis or any other basis which might be more economical than the retail purchase of such products." App. B, at 156 (556 F. 2d at 1382).

Congress did not contemplate that the McCarran Act be utilized to insulate all activities by insurers from the federal antitrust laws. As one Court recently observed,

> "The role of insurance in our complex commercial society is pervasive. Insurance companies with their policies, their agents and their customers touch and concern all commercial activity. The McCarran-Ferguson Act did not purport to make state legislation supreme in regulating all the activities of insurance *companies*. It does allow the states to regulate the *business* of insurance . . . but such business is not the subject of this litigation." *Devoto vs. Pacific Fidelity Life Ins. Co.*, 354 F. Supp. 874 (N.D. Calif. 1973) [emphasis in original], *aff'd as to holding on McCarran Act, rev'd and remanded on other grounds*, 516 F. 2d 1, 3 (9th Cir. 1975).

Such business likewise is not the subject of the present litigation!

Petitioners innocuously describes their price fixing conspiracy as "*negotiating* in advance the price of health care services furnished by the provider." Petition at 12 [emphasis added]. They attempt to justify such activity on the thesis that price fixing in the provider industry enables the insurer to offer reduced rates because the insurer will know in advance the cost of the benefits it will have to provide. *Id.* They also argue that they magnanimously are trying to stop the "rapid escalation in the cost of health care serv-

ices." Petition at 12. The Fifth Circuit correctly rejected these arguments with the following observation:

> That Blue Shield may wish to protect itself and its customers from rising costs in the pharmaceutical industry does not transform The Pharmacy Agreement into the business of insurance. App. B, at 15b (556 F. 2d at 1382).

A price fixing conspiracy is not automatically a part of the business of insurance merely because an insurer is a party to the conspiracy.

Although public spirited motives invariably are professed by price fixers, the fact remains that price fixing is illegal per se. "It makes no difference whether the motives of the participants are good or evil; . . . or whether the effect of the agreement is to raise or lower prices." *United States vs. McKesson & Robbins, Inc.*, 351 U.S. 305, 310 (1956). Nor can desirable business consequences justify price-fixing arrangements. *United States vs. Masonite Corp.*, 316 U.S. 265, 276 (1942). Congress has dictated that prices in the various private sectors of our economy are to be determined by free market forces, not by conspiracies among entities with market power.

Despite the laudable motives articulated by Petitioners in their Petition, Blue Shield merely is attempting to increase its profits at the expense of competition in the retail pharmaceutical industry, and the Petitioner pharmacy chains are attempting to eliminate small independent pharmacies as competitors. These activities do not constitute the "business of insurance."

If an insurer desires to minimize its risks by controlling the maximum dollar amount of each claim, it can specify in the insurance policy the maximum benefits available per

claim. Such activity does not infringe on competition and free market forces in private, non-insurance sectors of our economy.

Blue Shield has endeavored to stretch and distort the McCarran Act beyond Congress' wildest expectations. Congress never intended, and the Fifth Circuit refused to allow, the McCarran Act to be perverted in the manner sought by Blue Shield.

B. State Regulation of Health Insurance

Petitioners assert that the Fifth Circuit's decision "infringes upon the *extensive* state regulation of health care plans." Petition at 13 [emphasis added]. Were it not for the importance of the hallowed forum in which this ridiculous contention is being made, Petitioners' assertion would be ludicrous. In their protestations concerning "extensive state regulation of health care plans," Petitioners curiously avoid citation *of a single Texas statute* that is in any respect impaired, invalidated, or superseded by the Fifth Circuit's opinion.

In essence, Petitioners argue that state insurance commissioners and not the federal courts should decide what activities constitute the "business of insurance" for McCarran Act purposes. In this respect, Petitioners assert the following:

> This new and fundamental question of the manner in which insurers are to provide benefits to insureds at reasonable rates is precisely the type of question that the insurance commissioners of each state are most competent to examine through such administrative procedures as approval of rates and policy provisions. Petition at 14.

The question what constitutes the "business of insurance" is a federal question, not a question left to state insur-

ance commissioners. *See, S.E.C. v. Nat'l Securities, Inc.*, 393 U.S. 453 (1969); *S.E.C. v. Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959). Petitioners would have this Court retract its following construction of the McCarran Act:

> "The statute did not purport to make the States supreme in regulating all of the activities of insurance *companies;* its language refers not to the persons or companies who are subject to state regulation, but to laws "regulating the *business* of insurance." Insurance companies may do many things which are subject to paramount federal regulation; only when they are engaged in the "business of insurance" does the statute apply." *S.E.C. v. Nat'l Securities, Inc.*, 393 U.S. 453, 459-60 (1969) [emphasis in original].

Petitioners desire that this Court leave exclusively to the States regulation of any anticompetitive activity formulated by the ingenuity of insurers as long as an insurance company is a party to the activity. The McCarran Act does not grant such a blanket antitrust exemption, and the necessity for presrving a free marketplace in our society requires rejection of this wholesale abandonment of the federal antitrust laws.

Petitioners' argument that the Fifth Circuit's opinion "limits the insurer's function to paying bills and deprives insurers of the ability to *negotiate* the costs of benefits in order to reduce rates and increase coverage," is utterly fallacious. *See* Petition at 14 (emphasis added). The Fifth Circuit held that the McCarran Act will not shield from antitrust scrutiny insurers' conspiracies to fix prices, eliminate competition, and otherwise destroy free market forces in private, non-insurance sectors of our economy. Congress never intended that the McCarran Act be utilized to make private, non-insurance sectors of our economy sacrificial lambs for the benefit of the insurance industry.

CONCLUSION

Petitioners are in essence asking this Court to grant a writ of certiorari in order that this Court may decide a disagreement between the District Court and the Fifth Circuit concerning the operative facts of this case. The Fifth Circuit correctly rejected the District Court's erroneous construction of facts.

Petitioners have uncritically cited several cases for the blanket proposition that any and all activities embraced by health insurance plans and "provider agreements" are automatically a part of the "business of insurance." From such uncritical citation of cases involving facts and activities wholly alien to those before the Fifth Circuit, Petitioners try to create a conflict between the Fifth Circuit's decision and those by other courts of appeal. No such conflict exists.

The Fifth Circuit correctly rejected Petitioners' tortured and expansive reading of the McCarran Act. In so doing, it followed this Court's recent admonition that the various statutory exceptions to the antitrust laws are to be strictly construed. *See, Abbott Labs. v. Portland Retail Druggists Assn.*, ... U.S. ....., 96 S. Ct. 1305, 1313 (1976).

A central purpose of the antitrust laws is the promotion and preservation of marketplaces in which consumers are provided choices or options in terms of the prices, quality and services associated with the products they purchase. To that end, and for the reasons set forth above, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Joel H. Pullen, do hereby certify that a true and correct copy of the foregoing Respondents' Brief In Opposition To Petition For Writ of Certiorari was served on the Petitioners by mailing three copies thereof to each of their attorneys of record:

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APPENDIX A

Opinion of United States District Court for the Western District of Texas, June 23, 1976

ROYAL DRUG COMPANY d/b/a Royal Pharmacy of Castle Hills and Disco Prescription Pharmacy et al.

v.

GROUP LIFE AND HEALTH INSURANCE COMPANY a/k/a Blue Shield and/or Blue Cross-Blue Shield of Texas, et al.

Civ. A. No. SA-75-CA-131.

UNITED STATES DISTRICT COURT,
W. D. TEXAS
SAN ANTONIO DIVISION

June 23, 1976.

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Memorandum Opinion

JOHN H. WOOD, JR., *District Judge.*

I.

Plaintiffs in this private civil antitrust action are eighteen independent pharmacy owners doing business in San Antonio, Texas. Defendant Group Life and Health Insur-

ance Company, also known as Blue Shield of Texas ("Blue Shield"), is an insurance company duly authorized by the Texas State Board of Insurance to transact the business of life, health and accident insurance within the State of Texas. The remaining three Defendants, Walgreen Texas Co. ("Walgreen"), The Sommers Drug Stores Company ("Sommers"), and Rieger/Medi-Save Pharmacies, Inc. ("Rieger") operate pharmacies in San Antonio, Texas.

Plaintiffs' suit is an attack upon Blue Shield's plan of operation under certain prescription drug insurance policies (the "Policy") which it issues. It is alleged that Defendants have violated Section 1 of the Sherman Act, 15 U.S.C. § 1, by agreeing, combining and conspiring to fix the retail price of drugs and pharmaceuticals, and that the activities of Defendants have caused Blue Shield's insureds not to deal with certain of the Plaintiffs, thereby constituting a group boycott. Plaintiffs further allege that Defendants have violated the Texas antitrust laws, Tex. Bus. & Comm.Code Ann. § 15.01, *et seq.*, and that this Court should exercise pendent jurisdiction over those claims.

Each of the Defendants has separately moved to dismiss the Complaint for lack of jurisdiction over the subject matter and for failure to state a claim upon which relief can be granted. Defendants' motions are based upon the provisions of the McCarran-Ferguson Act, 15 U.S.C. § 1011, *et seq.* The motions also urge that in the absence of any valid cause of action based upon federal law, this Court should dismiss Plaintiffs' pendent claims.

Extensive discovery has been completed on the issue presently before the Court. The record includes numerous depositions, affidavits and documents, and all parties have had full opportunity to present all materials pertinent to Defendants' motions. The Court has carefully reviewed and considered all of those materials, together with the briefs submitted by the parties and the oral argument of counsel.

The facts relevant to Defendants' motions are undisputed. The Policies provide prescription drug insurance coverage. The benefits provided under the Policies entitle Blue Shield's insureds to receive prescription drugs from any pharmacy (a "Participating Pharmacy") that has entered into a written contract (the "Pharmacy Agreement") with Blue Shield. The Policies further provide that the insured is required to pay no more for each prescription filled by a Participating Pharmacy than the amount of the drug deductible set forth in the Policy. The drug deductible is $2.00. Pursuant to the terms of the Pharmacy Agreement, a Participating Pharmacy agrees to dispense drugs to Blue Shield's insureds and to accept $2.00 as full payment from the insured for each dispensed drug. Further, Blue Shield agrees to reimburse the Participating Pharmacy for the acquisition cost of each drug dispensed to its insureds. Under the terms of the Policy, if the insured has his prescriptions filled by a pharmacy other than a Participating Pharmacy, he must pay the full price charged by the pharmacy and then apply to Blue Shield for reimbursement. Blue Shield will then reimburse the insured for 75% of the usual and customary charge for the drug, less the $2.00 deductible.

Walgreen, Sommers and Rieger each own Participating Pharmacies. Blue Shield is not engaged in selling or dispensing prescription drugs as a manufacturer, wholesaler or retailer, but is engaged solely in transacting the business of life, health and accident insurance.

In 1969, Blue Shield sought authority from the Texas State Board of Insurance to begin issuing prescription drug insurance coverage in the form described above. Article 3.42 of the Texas Insurance Code provides that all new policy forms proposed to be issued by life, health and accident insurance companies must be filed with the State Board of Insurance and approved prior to issuance or use by the company. In March, 1969, Blue Shield filed with the

State Board of Insurance a proposed form of the Policy and the Pharmacy Agreement for approval prior to their issuance or use. The terms of the policy provided that Blue Shield's insureds were entitled to receive prescription drugs from Participating Pharmacies (called "participating providers" in the Policy). The Policy defined the term "participating provider" as a pharmacy who "has entered into a written contract [with Blue Shield] for the rendition of covered drugs for which benefits are provided by this [policy]." The Pharmacy Agreement was in the form described above.

In June, 1969, the Commissioner of Insurance issued a written order disapproving the issuance or use of the Policy. The Commissioner also notified the Texas Attorney General in writing of the action taken by the State Board and provided the Attorney General with copies of all pertinent documents. As a result of the disapproval order, Blue Shield did not issue or use the Policy or the Pharmacy Agreement.

Subsequent to the issuance of the disapproval order, the Policy and the Pharmacy Agreement remained under consideration by the State Board of Insurance. In September, 1969, pursuant to Article 3.42(e) of the Texas Insurance Code,* the Commissioner of Insurance issued another written order exempting the Policy from the approval requirements of Tex.Ins.Code Ann. art. 3.42.

The exemption order issued by the Commissioner of Insurance provided, in pertinent part:

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*"The Board of Insurance Commissioners may, by written order, exempt from the requirements of this Article for so long as it deems proper, any insurance document or form specified in such order to which in its opinion this Article may not practicably be applied, or the filing and approval of which are, in its opinion, not desirable or necessary for the protection of the public." Tex. Ins.Code Ann. art. 3.42(e).

"Pursuant to the authority granted by Article 3.42, Paragraph (e) of the Texas Insurance Code, the Commissioner of Insurance hereby exempts from the requirements of said Article Policy Form CC-OHDS-2 submitted by Group Life and Health Insurance Company, Dallas, Texas; and this exemption shall remain effective pending further orders from the Commissioner of Insurance.

"The exempt forms are described as drug service contracts, which confer upon the policy holder the right to obtain certain prescribed drugs at a cost fixed in the contract, the insurer having entered into participating agreements with dispensing pharmacies to supply the prescribed drugs to its policy holders."

It is clear that the exemption order exempted the Policy from nothing more than the requirement of approval by the State Board of Insurance. The former Deputy Commissioner of Insurance, who reviewed the Policy and the Pharmacy Agreement and then prepared the exemption order for the Commissioner's signature, testified on oral deposition that exempted policies are subject to all statutory requirements of the Texas Insurance Code and all regulatory requirements of the State Board of Insurance. He further testified that exempted policies and approved policies are subject to the same continuing regulation, control and supervision by the State Board. Other officials of the State Board of Insurance testified on oral deposition that exempted policies and approved policies are treated alike within the regulatory framework of the State Board of Insurance.

Further, the exemption order clearly shows that the Commissioner of Insurance considered the Pharmacy Agreement together with the Policy prior to issuing the exemption order. The exemption order authorized Blue Shield to issue and use the Policy in the State of Texas in

the same manner as if it had been approved. Subsequent to the issuance of the exemption order, the Commissioner again advised the Texas Attorney General in writing of his action and forwarded a copy of the exemption order to the Attorney General. The exemption order has not been modified or rescinded.

Thereafter, Blue Shield made a statewide mailing to licensed pharmacies offering them the option of entering into the Pharmacy Agreement. Subsequent to the issuance of the exemption order, Blue Shield has issued the policy to various groups and entered into the Pharmacy Agreement with pharmacies throughout the State of Texas.

In 1974, Blue Shield entered into a health care agreement to provide insurance benefits to groups in Bexar County, Texas. Included in the proposed coverage was prescription drug insurance. In September, 1974, pursuant to Tex.Ins.Code Ann. art. 3.42, a Policy form virtually identical to the one submitted in 1969 was filed with the State Board of Insurance for approval prior to issuance or use in connection with the Bexar County program. Thereafter, in October, 1974, the Commissioner of Insurance issued a written order approving the Policy for issuance. Since receipt of the approval order, Blue Shield has issued the Policy to various groups in Bexar County, Texas. Blue Shield offered to virtually all licensed pharmacies in San Antonio, Texas, the opportunity of entering into a Pharmacy Agreement. Nine of the Plaintiffs accepted Blue Shield's offer and now operate Participating Pharmacies.

Plaintiffs agree that Blue Shield is engaged in the business of issuing prescription drug insurance coverage; however, they contend that the McCarran-Ferguson exemption is inapplicable in that Blue Shield has exceeded the business of insurance by entering into the Pharmacy Agreements, and that such agreements have nothing to do with the business of insurance. Plaintiffs further contend that regardless of whether or not Blue Shield is engaged in the

business of insurance, Walgreen's, Sommers' and Rieger's participation in the Pharmacy Agreement is not the business of insurance.

For the reasons set forth herein, this Court does not agree with Plaintiffs' contentions. It is clear that the terms of the Policies which were reviewed by the State Board of Insurance and which it authorized Blue Shield to issue, expressly contemplate the execution of Pharmacy Agreements between Blue Shield and Participating Pharmacies. Moreover, the Pharmacy Agreement is so integrally related to the Policies that it would be impossible for Blue Shield to fulfill its contractual obligations to its insureds in the absence of such agreements.

The McCarran-Ferguson Act provides that ". . . the Sherman Act, . . . the Clayton Act, and the . . . Federal Trade Commission Act . . . shall be applicable to the business of insurance to the extent that such business is not regulated by State law." 15 U.S.C. § 1012(b). To the extent a state regulates such business by state law, the Sherman Act and the other federal antitrust laws are not applicable. The exemption is effective provided that two criteria are met: (1) that the "business of insurance" is involved, and (2) that there is state regulation of the business of insurance. The McCarran-Ferguson Act does not apply to acts of "boycott, coercion or intimidation." 15 U.S.C. § 1013(b).

II.

The Business of Insurance

In *SEC v. National Securities, Inc.*, 393 U.S. 453, 89 S.Ct. 564, 21 L.Ed.2d 668 (1969), the Supreme Court held that the "business of insurance" includes the relationship between the insurer and insured; the type of policy which could be issued, its reliability, interpretation and enforcement; and other activities of insurance companies which closely relate to their status as reliable insurers. *Id.* at 460,

89 S.Ct. 564. The Pharmacy Agreement directly pertains to the relationship between Blue Shield and its insureds. Moreover, the Pharmacy Agreement is a *direct* contractual relationship between the insurer and a provider of benefits, the result of which is simply the performance of the insurer's obligations owed to its insureds under the insurance contract and nothing more. A similar *direct* contractual relationship was examined in *Travelers Ins. Co. v. Blue Cross of West. Pennsylvania,* 481 F.2d 80 (3rd Cir. 1973) *cert. denied,* 414 U.S. 1093, 94 S.Ct. 724, 38 L.Ed.2d 550 (1973). In that case, the Third Circuit held that such contractual arrangements constituted the business of insurance, and thus, the relationship fell within the McCarran-Ferguson exemption. Direct contractual relationships between the insurer and a provider of benefits, as in this case, plainly relate to the "relationship between insurer and insured." The Pharmacy Agreement is based upon the provisions contained in the Policies relating to coverage and benefits, and directly concerns matters of interpretation and enforcement of the Policies. Clearly, the method adopted by Blue Shield of providing benefits under the Policies is closely connected to the relationship between Blue Shield and its insureds. The activities challenged by Plaintiffs in this action, including Blue Shield's contractual arrangements with Participating Pharmacies, constitute the business of insurance within the meaning of *SEC v. National Securities, Inc., supra.*

A program substantially similar in concept and operation to the one at issue was previously determined by the Texas Attorney General to constitute the business of insurance in the State of Texas. In response to a request for an opinion from the Texas Commissioner of Insurance, the Attorney General analyzed a prescription drug program which contemplated the filling of subscriber's prescriptions by participating pharmacies. The plan of operation was based upon a contract between the company and participating pharmacies, whereby the pharmacy agreed to charge

the subscriber no more than a certain percentage of the retail price of the prescription, and the company agreed to reimburse the pharmacy for the remainder. After thoroughly discussing the program the Attorney General concluded that ". . . the plan of operation intended to be followed by Prepaid Prescription Plan, Inc. would involve the doing of an insurance business in this state". Texas Attorney General's Opinion No. WW-1475 (Dec. 11, 1962).

This Court concludes that Blue Shield's plan of operation under the prescription drug insurance Policies, including the Pharmacy Agreements, constitutes the "business of insurance" within the meaning of the McCarran-Ferguson Act.

III.

State Regulation

A. *General Regulation.*

The McCarran-Ferguson Act renders the federal antitrust laws inapplicable when state legislation generally proscribes, permits, or otherwise regulates the conduct in question and authorizes enforcement through a scheme of administrative supervision. *Crawford v. American Title Ins. Co.,* 518 F.2d 217 (5th Cir. 1975); *FTC v. National Cas. Co.,* 357 U.S. 560, 78 S.Ct. 1260, 2 L.Ed.2d 1540 (1958); *Commander Leasing Co. v. Transamerica Title Ins. Co.,* 477 F.2d 77 (10th Cir. 1973).

The State of Texas has actively regulated the activities challenged in Plaintiff's Complaint since the inception of Blue Shield's prescription drug insurance program. The requirement of Article 3.42 of the Texas Insurance Code that all policy forms must be filed for review and approval by the State Board of Insurance prior to issuance or use by the insurer was fully satisfied. Active regulation of the prescription drug insurance program is further shown by the written orders issued by the Commissioner of Insurance and by the fact that the Texas Attorney General was

also kept fully advised of Blue Shield's prescription drug insurance program.

B. *Regulation Of Unfair Methods Of Competition In The Business of Insurance.*

Not only is there a scheme of general state regulation of the business of insurance involved in this action, but the Texas Insurance Code contains specific provisions applicable to the conduct alleged in Plaintiffs' Complaint. In 1951, the Texas Legislature enacted Tex.Ins.Code Ann. art. 21.21, which expressly regulates unfair competition and unfair practices in the business of insurance. The declaration of purpose of the Act states:

> "The purpose of this Act is to regulate trade practices in the business of insurance in accordance with the intent of Congress as expressed in the Act of Congress of March 9, 1945 (Public Law 15, 79th Congress) [the McCarran-Ferguson Act], by defining, or providing for the determination of, all such practices in this state which constitute unfair methods of competition or unfair or deceptive acts or practices and by prohibiting the trade practices so defined or determined." Tex.Ins.Code Ann. art. 21.21 § 1.

Article 21.21 specifically prohibits "*any* trade practice which is defined in [the] Act as, or determined pursuant to [the] Act to be, an unfair method of competition or unfair or deceptive act or practice in the business of insurance." Tex.Ins.Code Ann. art. 21.21 § 3. (Emphasis added) That statute grants specific administrative and supervisory powers to the State Board of Insurance, including the power to issue cease and desist orders. Penalties are provided for violation of such orders. Without doubt, the phrase "any" unfair method of competition encompasses the conduct challenged in this action. Furthermore, the oral deposition testimony establishes that the State Board of Insurance reviews all policy forms submitted to it with a view toward

insuring compliance with Article 21.21, and that approved, as well as exempted policies, are subject to its provisions. Article 21.21 was specifically intended by its drafters to respond to the invitation of the McCarran-Ferguson Act and to withdraw from federal control the very conduct charged by Plaintiffs in this action, and to place such conduct under state control. Article 21.21 constitutes sufficient state regulation to activate the exemption provided in the McCarran-Ferguson Act. *Crawford v. American Title Ins. Co.*, 518 F.2d 217 (5th Cir. 1975); *Dexter v. Equitable Life Assurance Soc'y of the U. S.*, 527 F.2d 233 (2nd Cir. 1975).

C. *The Texas Antitrust Laws.*

In addition to the comprehensive regulation of Blue Shield's activities provided by the Texas Insurance Code, anticompetitive practices in the business of insurance are also regulated by the Texas antitrust laws. The Texas antitrust laws declare categorically that "[e]very monopoly, trust, and conspiracy in restraint of trade . . . is illegal and prohibited." Tex.Bus. & Comm. Code Ann. § 15.04(a). Further, the Texas antitrust laws specifically prohibit conspiracies of the type alleged in Plaintiffs' Complaint. Tex. Bus. & Comm.Code Ann. § 15.02. It should be noted that Plaintiffs have included in their Complaint a pendent claim under the Texas antitrust laws based upon the same facts that Plaintiffs allege give rise to a violation of the federal antitrust laws.

The existence of a state antitrust law proscribing the conduct complained of constitutes "regulation" within the meaning of the McCarran-Ferguson Act sufficient to displace the federal antitrust laws. *Meicler v. Aetna Cas. and Sur. Co.*, 506 F.2d 732 (5th Cir. 1975); *Sanborn v. Palm*, 336 F.Supp. 222 (S.D.Tex.1971); *Transnational Ins. Co. v. Rosenlund*, 261 F.Supp. 12 (D.Ore.1966); *California League of Ind. Ins. Producers v. Aetna Cas. & Sur. Co.*, 175 F.Supp. 857 (N.D.Cal.1959).

Therefore, in addition to active regulation under the Texas Insurance Code, the existence of state antitrust statutes forbidding the conduct alleged by Plaintiffs constitutes state regulation of the business of insurance sufficient to bar application of the federal antitrust laws.

IV.

The Boycott Exception to the McCarran-Ferguson Act Is Inapplicable

As in *Meicler v. Aetna Cas. and Sur. Co., supra,* Plaintiffs attempt to avoid the effect of the McCarran-Ferguson exemption by relying on the Section 1013(b) boycott exception. Plaintiffs' reliance on this exception is misplaced. The courts have narrowly construed Section 1013(b), which provides:

> "Nothing contained in this chapter shall render said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion or intimidation." 15 U.S.C. § 1013(b).

The sole purpose of this exception is to protect against the issuance of black-lists naming insurance companies or agents, rather than the conduct alleged by Plaintiffs in this action.

In *Meicler*, the Court stated:

> "As the district court noted, the legislative history indicates that the boycott exception was designed to reach insurance company 'black-lists' rather than refusal to sell to a particular segment of the public at other than a specified price. (Citations omitted) Appellants' broad construction of Section 1013(b) would emasculate the antitrust exemption contained in Section 1012(b) of the McCarran-Ferguson Act. We affirm the district court's holding that the boycott exception does not apply." 506 F.2d at 734.

This case does not involve black-listing and the boycott exception is inapplicable. *Addrisi v. Equitable Life Ins. Assurance Soc'y of the U. S.*, 503 F.2d 725 (9th Cir. 1974); *Proctor v. State Farm Mut. Auto Ins. Co.*, 406 F.Supp. 27 (D.D.C.1975); *Mitgang v. Western Title Ins. Co.*, Trade Reg.Rep. (1974-2 trade cases) ¶ 75,322 at 98,024 (N.D.Cal. October 16, 1974); *Transnational Ins. Co. v. Rosenlund*, 261 F.Supp. 12 (D.Or.1966).

V.

Application of the McCarran-Ferguson Act to the Non-Insurance Company Defendants

Plaintiffs contend that Walgreen, Sommers and Rieger are not entitled to the protection afforded by the McCarran-Ferguson Act because they are not insurance companies. The exemption provided in the Act is not strictly limited to insurance companies. As shown herein, it is the "business of insurance" with which the Act is concerned.

Recent cases have allowed the exemption even though the challenged activities involved parties other than insurance companies. In *Travelers Ins. Co., v. Blue Cross of West. Pennsylvania*, 481 F.2d 80 (1973), the Court applied the exemption to contracts between the insurance company and hospitals. In *Schwartz v. Commonwealth Land Title Ins. Co.*, 374 F.Supp. 564 (E.D.Pa. 1974), the exemption was applied to a fee charged to sellers of real estate by title insurance companies and agents.

It is clear that it is the nature of the conduct involved which must be looked at in order to determine whether or not the exemption should be applied. In the instant case, Walgreen, Sommers and Rieger, by having contractually agreed with Blue Shield to provide the benefits set out in the Policy, have become an integral part of the overall scheme of insurance coverage which is regulated by state law. Such integration of the providers of benefits under the

Policies into the overall scheme places their actions under the Pharmacy Agreements within the "business of insurance", and they are therefore entitled to the protection afforded by the McCarran-Ferguson Act for it is clear that one cannot be brought within the web of potential liability under the Federal Antitrust laws for participation in the complained of activity if such activity is, as in the instant case, exempt by operation of the McCarran-Ferguson Act.

VI.

Plaintiff's Pendent Claims

As shown above, the complained of activities are exempt from the Federal Antitrust laws because of the McCarran-Ferguson Act. It is clear from the pleadings on file that jurisdiction over this action does not exist by reason of diversity of citizenship. If the Federal claims are dismissed prior to trial, it is within the ambit of this Court's discretion to decline to continue to exercise jurisdiction over the pendent state claims. No unusual circumstances are present in this case which would require the Court to retain jurisdiction over the pendent claims. *United Mine Workers of America v. Gibbs,* 383 U.S. 715, 86 S.Ct. 1130, 16 L.Ed.2d 218 (1966); *Lazier v. Weitzenfeld,* 505 F.2d 896 (5th Cir. 1975); *Kavit v. A. L. Stamm & Co.,* 491 F.2d 1176 (2nd Cir. 1974).

VII.

Conclusion

For the reasons set forth above, this Court concludes that the complained of activities constitute the "business of insurance". This Court further concludes that the State of Texas has regulated and is actively and effectively regulating such business of insurance within the meaning of the McCarran-Ferguson Act, and the Federal Antitrust laws are thereby rendered inapplicable. Accordingly, Defend-

ants' motions will be granted. As shown herein, this Court has considered matters outside the pleadings in arriving at its decision. In doing so, the essentials necessary to support the exemption have been found to exist. Therefore, it is appropriate that Defendants' motions shall be treated as Motions for Summary Judgment and disposed of as provided in Rule 56, Federal Rules of Civil Procedure. The foregoing Memorandum Opinion constitutes the Court's Findings of Fact and Conclusions of Law.

An Order consistent with the foregoing will be entered.

APPENDIX B

ROYAL DRUG COMPANY, INC., d/b/a Royal Pharmacy of Castle Hills and Disco Prescription Pharmacy, et al., Plaintiffs-Appellants,

v.

GROUP LIFE AND HEALTH INS. CO., a/k/a Blue Shield and/or Blue Cross-Blue Shield of Texas, et al., Defendants-Appellees.

No. 76-2746.

United States Court of Appeals, Fifth Circuit.

Aug. 8, 1977.

Rehearing and Rehearing En Banc
Denied Oct. 27, 1977.

Independent, nonparticipating pharmacies brought antitrust action against defendant participating pharmacies and group insurer providing prescription drug coverage policies. The United States District Court for the Western District of Texas, at San Antonio, 415 F. Supp. 343, John H. Wood, Jr., J., entered judgment for the defendants and the plaintiff pharmacies appealed. The Court of Appeals, James C. Hill, Circuit Judge, held that: (1) statutory exemptions to antitrust laws required strict construction, and (2) contractual agreement between insurer and participating pharmacies providing for a limited markup equal to policyholder's deductible for each prescription and providing for direct reimbursement of participating pharmacies as opposed to 75% reimbursement to insureds dealing with nonparticipating pharmacies did not constitute "business of insurance" within the exemption provision of McCarran Act.

Reversed.

1. Monopolies — 10

Statutory exceptions to antitrust laws are to be strictly construed. Sherman Anti-Trust Act, § 1 et seq., 15 U.S.C.A. § 1 et seq.; McCarran- Ferguson Act, § 1 et seq., 15 U.S.C.A. § 1011 et seq.

2. Monopolies — 18

Merely because challenged conduct has been engaged in by an insurance company does not dictate its characterization as the "business of insurance" under McCarran Act providing that the federal antitrust laws are applicable to business of insurance only to the extent it is not regulated by state law; question presented under Act is whether activities complained of are part of business of insurance which Congress sought to remove from federal regulation. McCarran-Ferguson Act, § 1 et seq., 15 U.S.C.A. § 1011 et seq.

See publication Words and Phrases for other judicial constructions and definitions.

3. Monopolies — 18

Every action taken by insurance company to enhance its status as a reliable insurer does not necessarily constitute "business of insurance" within meaning of McCarran Act excluding business of insurance from federal antitrust laws to the extent it is regulated by state law. McCarran-Ferguson Act, § 1 et seq., 15 U.S.C.A. § 1011 et seq.

4. Monopolies — 18

Agreement which does not otherwise constitute "business of insurance" is not automatically embraced within protection of McCarran Act simply because it benefits policyholders either directly or indirectly by the strengthening

financial condition of insurer. McCarran-Ferguson Act, § 1 et seq., 15 U.S.C.A. § 1011 et seq.

5. Monopolies — 18

Agreement between group insurer providing prescription drug coverage and participating pharmacies limiting markup of such pharmacies to the two-dollar deductible under each policy and providing for direct reimbursement of total cost less deductible from insurer, as opposed to insurer's reimbursement of its insureds of only 75% when dealing with nonparticipating pharmacies, did not constitute a part of the "business of insurance" and was not shielded from antitrust scrutiny under the McCarran Act, even though agreement may have had some effect on policyholders and rates. Sherman Anti-Trust Act, § 1 et seq., 15 U.S.C.A. § 1 et seq.; McCarran-Ferguson Act, § 1 et seq., 15 U.S.C.A. § 1011 et seq.

6. Insurance — 3.1

Federal courts generally give heavy weight to state's determination that an activity constitutes "business of insurance" for purpose of McCarran Act exemption. McCarran-Ferguson Act, § 1 et seq., 15 U.S.C.A. § 1011 et seq.

7. Monopolies — 18

Activity is not a part of "business of insurance" within an antitrust exemption provision of McCarran Act solely because it has impact, favorable or otherwise, on premiums charged by insurer, and practices do not become clothed with McCarran Act protection simply because insurance company has contracted to pay provider for products or services. McCarran-Ferguson Act, § 1 et seq., 15 U.S.C.A. § 1011 et seq.

Joel H. Pullen, Stephen F. Lazor, San Antonio, Tex., for plaintiffs-appellants.

Keith E. Kaiser, R. Laurence Macon, J. Burleson Smith, San Antonio, Tex., for Group Life & Health.

William C. Church, Jr., San Antonio, Tex., for Walgreen Texas Co.

Richard B. Moore, San Antonio, Tex., for Sommers Drug Stores Co.

Charles R. Shaddox, San Antonio, Tex., for Rieger-Medi-Save Pharmacies, Inc.

Appeal from the United States District Court for the Western District of Texas.

Before GOLDBERG and HILL, Circuit Judges, and KERR,* District Judge.

James C. HILL, Circuit Judge:

The plaintiffs in this civil antitrust action are eighteen independent pharmacy owners doing business in San Antonio, Texas.[1] Blue Shield is a Texas insurance company authorized by the State Board of Insurance of Texas to sell life, health and accident insurance. Three other defendants, Walgreen Texas Company, The Sommers Drug Stores Company and Rieger Medi-Save Pharmacies, Inc., also operate pharmacies in San Antonio, Texas.

The plaintiffs contend that the defendants have violated Section 1 of the Sherman Act, 15 U.S.C. § 1, by agreeing, combining and conspiring to fix the retail price of drugs and pharmaceuticals, and that the activities of the defendants have caused Blue Shield's insureds not to deal with certain

* Senior District Judge for the District of Wyoming, sitting by designation.

[1] Since the parties have been referred to in the briefs as plaintiffs and defendants, as they were in the district court, they will be so designated in this opinion. The defendant Group Life & Health Insurance Company will be referred to herein as Blue Shield.

of the plaintiffs, thereby constituting an unlawful group boycott. Plaintiffs also allege violations of Texas antitrust law over which the district court took pendent jurisdiction. The defendants affirmatively alleged in their answers that pursuant to the provisions of the McCarran-Ferguson Act, 15 U.S.C. § 1011, *et seq.*, ("McCarran Act") the complaint failed to state a claim upon which relief could be granted and that the district court lacked subject matter jurisdiction. On the basis of the McCarran Act, each defendant moved to dismiss the complaint pursuant to Rule 12(b), F.R.Civ.P. The defendants also moved that the court treat their motions as motions for summary judgment pursuant to Rule 56, F.R.Civ.P. Defendants further moved the court to dismiss the claims based upon state law if the court found there was not a proper cause of action based upon federal law. The district court held that: (1) the conduct complained of by the plaintiffs constitutes the business of insurance; (2) the State of Texas has regulated and is actively regulating such business of insurance within the meaning of the McCarran Act; (3) that the boycott exception to the McCarran Act is inapplicable to the instant case; and (4) that the federal antitrust laws are, therefore, rendered inapplicable. We reverse.

I. *The facts.*

Plaintiffs are challenging a plan of operation under which Blue Shield issues certain prescription drug insurance policies which entitle Blue Shield's insureds to purchase drugs from any pharmacy. If the pharmacy selected by the policyholder has entered into a written contract ("Pharmacy Agreement") with Blue Shield, the insured is required to pay only two dollars ($2.00), the amount of the drug deductible set forth in the policy. On the other hand, if the insured has his prescription filled by a pharmacy other than a Participating

Pharmacy, he is required to pay the full price charged by the pharmacy, as well as the $2.00 deductible, and then to apply to Blue Shield for reimbursement. Blue Shield will then reimburse the insured only for 75 percent of the usual and customary charge for the drug, less the $2.00 deductible.[2]

In 1969, Blue Shield sought approval from the Texas State Board of Insurance to begin issuing prescription drug insurance coverage. The Commissioner, however, disapproved the issuance or use of such a policy. The policy remained under the consideration of the Commissioner and in September, 1969, the Commissioner issued an order exempting the policy from the approval requirements of Texas law. The defendants contend that there is uncontradicted evidence showing that an exemption order exempts the policy from nothing more than the requirement of approval by the State Board of Insurance, and that exempted policies, as well as approved policies, are subject to all statutory requirements of the Texas Insurance Code and the continuing regulation, control and supervision of the State Board of Insurance.

When the Commissioner issued his orders concerning the plan, disapproving it in the first instance, and then exempting the plan, he advised the Texas Attorney General in writing of his actions on each occasion. After receiving the exemption order, Blue Shield made a statewide mailing to licensed pharmacies offering them the privilege of entering into the Pharmacy Agreement. As a result, Blue Shield has issued the policy to various groups and has entered into the Pharmacy Agreement with pharmacies throughout the State of Texas.

In 1974, Blue Shield entered into a health care agreement, which included prescription drug insurance, to provide insur-

[2] The usual and customary charge is established by Blue Shield and is determined by reference to its compilation of such charges.

ance benefits to groups in Bexar County, Texas. In order to implement this agreement, in September, 1974, a policy form virtually identical to the one submitted in 1969 was filed with the State Board of Insurance for approval prior to its issuance or use. This policy was approved in October, 1974. Subsequently, Blue Shield has issued the policy to various groups in Bexar County and has offered to virtually all licensed pharmacies in San Antonio the opportunity of entering into the Pharmacy Agrement. Nine of the plaintiffs in this case accepted Blue Shield's offer and now operate Participating Pharmacies. In recent years, the number of pharmaceutical sales covered by this policy have risen dramatically. For example, between early 1972 and October, 1975, there was a 3,100 percent increase in the number of pharmaceutical claims processed by Blue Shield under the policy. In October, 1975, Blue Shield was handling these claims at the rate of approximately 31,000 claims per month as compared with only 1,000 claims per month in early 1972.

For each sale made under the plan, a Participating Pharmacy is limited to a $2.00 markup, which is known as a "professional dispensing fee," irrespective of its actual acquisition cost for a particular drug. The plaintiffs note that, with respect to highly expensive drugs, the Pharmacy Agreement can result in a markup of no more than two percent, which will not even cover the interest on its investment in inventory.

II. *Summary of Contentions on Appeal.*

The plaintiffs argue that the retail sales price, as fixed in the Pharmacy Agreement between Blue Shield and the defendant pharmacy chains, has been set at a level below that at which small independent pharmacies can profitably conduct business. They claim that only large, high volume chains that sell many items in addition to drugs can

afford to operate pursuant to the Pharmacy Agreement. They also contend that the Agreement fixes the retail price of drugs at a level which eliminates the only effective means by which small independent pharmacies can compete with the large chains — the provision of services. They argue that, since signatories of the Pharmacy Agreement are limited to the same retail sales price whether they provide home deliveries, twenty-four service, or no service at all, the ability of the independents to compete is effectively destroyed. The plaintiffs contend that Blue Shield's plan of operation not only encompasses the fixing of prices in the defendant pharmacy chains, but it extends to the pharmaceutical industry as a whole. They contend that small independent pharmacies are given the choice of either signing the price fixing agreement or being forced out of business.

The plaintiffs also argue that there are two types of coercion of Blue Shield's subscribers inherent in the plan. First, the subscriber receives markedly reduced benefits if he patronizes a pharmacy that refuses to sign the price-fixing agreement. Although he would pay only the $2.00 drug deductible for each prescription filled by a participating pharmacy, he would ultimately pay an amount representing 25 percent of a reasonable charge for the drug, in addition to the $2.00 drug deductible, for each prescription filled by a nonsigning pharmacy. The plaintiffs also point out that the differential in benefits between participating and nonparticipating pharmacies is intended to coerce Blue Shield's policy holders not to patronize nonsigning pharmacies *in Texas* and thereby to coerce such pharamacies to sign the price-fixing agreement. This allegation is based on the policy itself, which provides that the subscriber will be reimbursed 100 percent of a reasonable charge for the drug, less the $2.00 drug deductible, when he patronizes a nonsigning pharmacy outside the State of Texas.

The plaintiffs also contend that there is a second and more subtle step to the coercion. If a pharmacy signs the Pharmacy Agreement and agrees to charge only the stipulated amount for drugs sold to Blue Shield subscribers, it will be reimbursed directly by Blue Shield in the amount of the acquisition cost, and the subscriber will be obligated to pay the pharmacy at the time of purchase only the $2.00 drug deductible. If the pharmacy has refused to sign the Agreement, however, Blue Shield will not deal with the pharmacy directly, and the subscriber must pay the entire retail sales price at the time of purchase, in addition to the $2.00 fee. After paying the entire sales price at the time of purchase, he must file a claim with Blue Shield seeking reimbursement. Thus, an insured has the additional burden of filing a claim for reimbursement, and he must accept reduced benefits in order to patronize the drug store of his choice.

Having made the above claims, the plaintiffs are immediately confronted with defendant's argument that its activities are exempt from the antitrust laws by virtue of the McCarran Act. The McCarran-Ferguson Act provides that the Sherman Act, the Clayton Act and the Federal Trade Commission Act shall be applicable to the business of insurance only "to the extent that such business is not regulated by state law."

Disputing the applicability of the McCarran Act exemption, the plaintiffs contend that a three-step analysis is necessary to determine whether an insurance company's challenged activities fall within the Act's exemption. First, they contend, the court must determine whether the challenged activities constitute the "business of insurance." Second, it must determine whether the activities in question are regulated by state law. Third, the court must determine

the presence or absence of boycott, coercion, or intimidation.[3] The latter requirement derives from Section 3(b) of the McCarran Act, which states as follows: "Nothing contained in this chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate or act of boycott, coercion or intimidation." 15 U.S.C. § 1013(b) (1970).

III. *Do the Defendants' Activities Constitute the Business of Insurance?*

[1, 2] The stepping off point of our analysis is the general principle that statutory exceptions to the antitrust laws "are to be strictly construed." *Abbott Labs v. Portland Retail Druggists Ass'n, Inc.*, 425 U.S. 1, 96 S. Ct. 1305, 47 L. Ed. 2d 537 (1976); *FMC v. Seatrain Lines, Inc.*, 411 U.S. 726, 93 S. Ct. 1773, 36 L. Ed. 2d 620 (1973). The notion that "our cases have repeatedly established * * * a *heavy presumption against* implicit [antitrust] exemptions" was recently reaffirmed in *Abbott Labs., supra.*[4] Moreover, it is clear that merely because challenged conduct has been engaged in by an insurance company does not dictate its characterization as the "business of insurance" under the McCarran Act. *SEC v. National Securities, Inc.*, 393 U.S. 453, 89 S. Ct. 564, 21 L. Ed. 2d 668 (1969). The question presented under the McCarran Act, therefore, "is whether the activities complained of, *even though they may be actions taken by an insurance company*, are part of the 'business of insurance'

[3] A negative finding for the first question obviates the necessity for a determination with respect to the second and third steps, and precludes application of the McCarran Act. *SEC v. Nat'l Securities, Inc.*, 393 U.S. 453, 89 S. Ct. 564, 21 L. Ed. 2d 668 (1969); *American General Insurance Co. v. FTC*, 359 F. Supp. 887 (S.D. Tex. 1973), *aff'd.*, 496 F. 2d 197 (5th Cir. 1974).

[4] Relying on this general principle, plaintiffs argue that if the challenged activities do not clearly constitute the business of insurance, they fall outside the McCarran Act's protective umbrella and are subject to the full force and effect of the antitrust laws.

which Congress sought to remove from federal regulation." *Fry v. John Hancock Mutual Life Ins. Co.*, 355 F. Supp. 1151, 1153 (N.D. Tex. 1973) (emphasis added).

In *National Securities* the Supreme Court held that the "business of insurance" included (1) "the relationship between insurer and insured," (2) "the type of policy which could be issued, its reliability, interpretation and enforcement;" (3) "other activities which relate * * * to their status as reliable insurers." Relying on the first of these definitions, the plaintiffs note that the McCarran Act's focus is on the relationship between the insurer and the insured. The plaintiffs argue that a crucial determination is the question how closely the challenged activity concerns the relationship between the insurance company and the policyholder. The activities challenged herein, according to the plaintiffs, relate primarily to relationships other than that between the insured and its policyholders and therefore are not peculiar to the insurance industry. The plaintiffs concede that there may be effects on policyholders resulting from the Pharmacy Agreement, but they minimize these as peripheral and secondary to the effects on the relationships between competing pharmacies and between such pharmacies and their customers.

[3, 4] The defendants contend, and the district court found, that the plan of operation followed by Blue Shield, including the Pharmacy Agreement, relates directly to its status as a reliable insurer. We cannot agree. It is beyond peradventure that every action taken by an insurance company to enhance its status as a "reliable insurer" does not necessarily constitute the "business of insurance" within the meaning of the McCarran Act. Moreover, an agreement which does not otherwise constitute the business of insurance is not automatically embraced within the protection

of the McCarran Act simply because it benefits policyholders either directly, or indirectly by strengthening the financial condition of the insurer.

[5] Defendants allege that the contractual arrangements between Blue Shield and Participating Pharmacies require nothing more than the performance of obligations owed to Blue Shield's insureds under the drug insurance policies. In concluding that "[t]he Pharmacy Agreement directly pertains to the relationship between Blue Shield and its insureds," the district court held that the Pharmacy Agreement "is simply the performance of the insurer's obligations owed to its insureds under the insurance contract and nothing more." Despite these characterizations of the contractual arrangement, we find that the agreements between Blue Shield and Participating Pharmacies do not require Blue Shield to fix prices or to produce other anticompetitive effects in the pharmaceutical industry. Blue Shield's sole obligation is to see that the insured receives prescription drugs and "shall be required to pay no more than the drug deductible for each of such covered drugs." It is unnecessary for Blue Shield to agree with pharmacies to fix retail sales prices in the pharmaceutical industry. Blue Shield's policyholders are basically unconcerned with the contract between the insurer and the Participating Pharmacy. They are obligated to pay a Participating Pharmacy two dollars ($2.00) for a prescription regardless of the presence or absence of a price fixing arrangement. Thus, by minimizing costs and maximizing profits, the Participating Pharmacy Agreements inure principally to the benefit of Blue Shield.

The plaintiffs attempt to illustrate by example that the relationship primarily affected by the Pharmacy Agreement and the alleged coercion is that between competing pharmacies and not the relationship between insurer and insured.

If the challenged activities in this case are held to constitute the business of insurance, they contend, then automobile insurers will be able to utilize Participating Repair Shop Agreements and coercion to fix prices for parts and labor in the automobile industry. Similarly, they contend that fire insurance companies would be able to execute Participating Construction Company Agreements and thereby combine and conspire with large construction companies to set prices for the repair and rebuilding of homes or buildings damaged by fire. The plaintiffs contend that Congress never intended that the McCarran Act be utilized to shield such activities from application of the federal antitrust laws. They note that Congress, in enacting the McCarran Act, may have condoned state supervised rate setting, but Congress was opposed to private price fixing and did not intend that such activity be shielded from federal scrutiny.

The defendants argue that the Pharmacy Agreement is so inextricably intertwined with the policies that it would be impossible for Blue Shield to fulfill its contractual obligations to its insureds in the absence of such agreements with the pharmacies. The defendants also dispute plaintiffs' arguments that if Blue Shield's activities are permitted, automobile insurers will utilize Participating Repair Shops and fire insurance carriers will enter into Participating Construction Company Agreements. The defendants contend that the types of insurance referred to by the plaintiffs are not at issue here and such types of insurance are regulated by the provisions of the Texas Insurance Code which are not similar to the ones involved in this case. They also contend that Blue Shield was statutorily required to submit the policies to the state board prior to issuance or use and that the Commissioner authorized the use of the policy and Pharmacy Agreement. Finally, they contend that the activities suggested in the hypothetical examples would require

careful examination of the existing laws and regulatory devices relating to automobile insurance and fire insurance. In short, they contend that these hypotheticals are nothing more than speculation and conjecture.

We conclude that Blue Shield is no more obligated to fix the retail prices of pharmaceuticals than an automobile insurer is obligated to its insureds having deductible policies to fix the prices charged for parts and labor. Just as the automobile insurer is obligated to pay the cost of repair, whatever it might be, over and above the applicable policy deductible, Blue Shield is obligated to pay the cost of prescription drugs over and above the two dollars ($2.00) drug deductible. Even though an automobile insurer might be able to guarantee by contract that repairs are done for its customers on a "cost" basis, thereby achieving increased profits or reduced rates, such agreements do not thereby become immune from antitrust scrutiny. *Contra, Proctor v. State Farm Mutual Insurance Co.*, 406 F. Supp. 27 (D.D.C. 1975).

The plaintiffs next contend that the Pharmacy Agreement produces results far beyond the simple performance of Blue Shield's responsibilities owed to its insureds under The Prescription Drug Insurance Policy. Blue Shield itself may have recognized that the Pharmacy Agreement goes beyond its obligations under the prescription plan. The plaintiffs introduced into evidence a letter between two Blue Shield executives which indicated a concern over antitrust problems and suggested that the company camouflage the price fixing arrangement as a "mass accounting agreement." The evidence introduced in the trial court stated as follows: "I think it would be best to draft the contract so that the Insurance Board would require filing of the mass accounting agreement [Pharmacy Agreement] to strengthen your base on anti-

trust. Drafting problems will get sticky here, but let's pass on that for now." The plaintiffs contend that this letter carries the Blue Shield plan far beyond the protection of the McCarran Act. They contend that Congress did not contemplate or intend that the McCarran Act should shield from antitrust scrutiny any insurance company's efforts to control the magnitude of its policyholder's claims through the elimination of price and other forms of competition in the industries providing goods and services covered by the insurance policy. Since these activities are not regulated by the State, they contend that the McCarran Act exemption does not apply.

We find that the Pharmacy Agreement goes beyond Blue Shield's obligations as an insurer and places the firm in the business of providing products and services. Blue Shield has agreed to provide protection against the risk that a policyholder will require pharmaceuticals. In order to meet that obligation, Blue Shield is not required to guarantee the provision of services on a "cost-plus" basis or any other basis which might be more economical than the retail purchase of such products. That Blue Shield may wish to protect itself and its customers from rising costs in the pharmaceutical industry does not transform the Pharmacy Agreement into the business of insurance. In fact, the best way for the firm to protect itself from rising costs is to establish and periodically adjust its rate structure to reflect the impact of inflation. Such measures, which are by no means foreign to the insurance business, involve far less intrusion into the pharmaceutical industry and, consequently, avert the potentially anticompetitive effects alleged here.

The plaintiffs next attempt to come to grips with *Travelers Insurance Company v. Blue Cross*, 481 F. 2d 80 (3rd Cir.), *cert. denied*, 414 U.S. 1093, 94 S. Ct. 724, 38 L. Ed. 2d

550 (1973), by arguing that the McCarran Act does not apply *ipso facto* to every direct contractual relationship between an insurance company and a provider of benefits. In *Travelers*, the Third Circuit held that the contractual arrangements consummated between Blue Cross and various hospitals for the furnishing of services under insurance policies constituted the business of insurance and, thus, the relationship fell within the McCarran Act exemption. There, as here, the relationship was a direct contractual relationship the result of which was the performance of obligations owed to the insured by the insurer on an economically favorable basis. The plaintiffs have attempted to distinguish *Travelers* by arguing that the Third Circuit was merely approving the actions of the Insurance Commissioner of Pennsylvania who was exerting pressure on the large insurance companies to exercise their power over hospitals to reduce hospital costs. This interpretation, with which we agree was adopted in *Doctors, Inc. v. Blue Cross*, 431 F. Supp. 5 (E. D. Pa. 1975), *aff'd. per curiam*, 557 F. 2d 1001 (3d Cir. 1976).[5] Moreover, the *Travelers* decision was based in large measure on the Pennsylvania legislature's control over rates charged by nonprofit hospitals. That regulation was undertaken pursuant to a statutorily created interrelationship between the rates charged by nonprofit health insurers and nonprofit hospitals, which interrelationship was to be regulated by the Pennsyl-

[5] The court indicated the narrow scope of *Travelers* as follows:
It is therefore readily apparent from the reading of the *Travelers* case that the Third Circuit is approving the *actions of the Insurance Commissioner of Pennsylvania when he exerts pressure* on the large insurance companies to get them to exercise their power over hospitals to force the hospitals to cut costs wherever possible. This is exactly what Blue Cross was doing in our case at the bequest of the Insurance Commissioner. Therefore, since the McCarran-Ferguson exemption was applicable in Travelers * * *, I hold today that the McCarran-Ferguson exemption is applicable in *Doctors, Inc.* * * *. *Doctors, Inc. vs. Blue Cross*, 431 F. Supp. 5, 10 (E.D. Pa. 1975), *aff'd* 557 F. 2d 1001 (3d Cir. 1976) (emphasis added).

vania Insurance Department. The plaintiffs note that the Texas Legislature has not chosen indirectly or directly to control the rates charged by pharmacies either by directing and controlling contracts between insurers and pharamacies or by creating an interrelationship between the rates charged by pharmacies and those charged by insurers. Since *Travelers* held simply that the contract between a nonprofit health insurer and a nonprofit hospital was shielded by the McCarran Act from attack, *Travelers* carries little precedential value in this appeal.

Rather, the instant case is more nearly akin to *Battle v. Liberty Nat'l Life Ins. Co.*, 493 F. 2d 39 (5th Cir. 1974), *cert. denied*, 419 U.S. 1110, 95 S. Ct. 784, 42 L. Ed. 2d 807 (1975). In *Battle* several funeral homes and directors brought suit against an insurer, which issued burial policies, and the insurer's wholly owned subsidiary, which supplied merchandise and services required by the insurer's policies. Although this court found coercion with respect to the insurer's discrimination in benefits, the court felt that the facts were inadequately developed to make a conclusive determination on the McCarran Act issue. Nonetheless, the court stated as follows: "[I]t might be plausibly argued that these facts do not constitute the business of insurance as contemplated by the McCarran Act and thus do not fall within its exemption."[6] The court noted that the obligations under the insurer's arrangement might be related to the business of insurance, but the obligations were so remotely

[6] The Court stated:
It appears that, since the insurance contract confers far more benefits upon the policyholder if he uses an authorized funeral home, the policyholder is subtly coerced into dealing only with the authorized home. The imposition of this restraint would effectively foreclose the unauthorized funeral director's access to a substantial portion of the market. 493 F. 2d at 44-45.
The court held that these facts "if established, would tend to support a finding of unreasonable restraint of trade." 493 F. 2d at 44.

related as to be subject to the antitrust laws. Relying on *Battle*, the plaintiffs argue that the defendants' activities challenged herein are not peculiar to the insurance industry and are not the business of insurance. They argue that by providing markedly decreased benefits to those subscribers who patronize a nonparticipating pharmacy, Blue Shield intentionally and overtly coerces its subscribers to boycott these pharmacies. Not only does this boycott operate to coerce the nonsigning pharmacies to participate in the plan, it also forecloses nonsigning pharmacies from a significant portion of the market and secures for participating pharmacies the sales of prescription drugs required by Blue Shield's claimants. Since this activity is not peculiar to the insurance industry, plaintiffs argue that it does not constitute the business of insurance. As in *Battle*, the contractual agreements here under review are somewhat related to the business of insurance. The relationship, however, is so attenuated that it must be subject to the antitrust laws. As the plaintiffs have so well articulated, "it is not the office of the insurance industry to set the prices in the various sectors of our economy so that insurers will enjoy an added measure of control over the magnitude of individual claims."

[6] The plaintiffs next take issue with the finding of the district court that a 1962 Opinion of the Texas Attorney General has concluded that the challenged activity constitutes the business of insurance. The court read the 1962 Opinion as a determination by the Texas Attorney General that a plan "substantially similar" to Blue Shield's plan constituted the business of insurance. Plaintiffs contend that the Attorney General's Opinion held only that the particular firm in question was an insurance company and not that a program substantially similar to Blue Shield's constituted the business of insurance. The plaintiffs allege that the

Attorney General's Opinion was based strictly on the facts presented and that it bears no logical relevance to the question whether the activities challenged in this suit constitute the business of insurance. Although the 1962 Opinion is not without ambiguity, it appears to focus on the status of the company itself; it does not conclusively establish whether the State considers a plan such as Blue Shield's Pharmacy Agreement to constitute "the business of insurance." Thus, we are compelled to eschew the heavy weight usually given a state's determination that an activity constitutes the "business of insurance" in favor of the interpretation given the term by the federal courts. See *SEC v. Variable Annuity Co.*, 359 U.S. 65, 69, 79 S. Ct. 618, 3 L. Ed. 2d 640 (1959).

The State has shed very little light on this matter since the 1962 Attorney General's Opinion discussed above. Although the plaintiffs argue that the State Board of Insurance does not consider The Pharmacy Agreement to encompass or constitute the business of insurance, it is by no means clear that the State has even considered the question. The district court concluded that "[t]he State of Texas has actively regulated the activities challenged in plaintiff's complaint since the inception of Blue Shield's Prescription Drug Insurance *Program*." (emphasis added). Plaintiffs contend that the district court uses the word "program" loosely in that the Board of Insurance approved nothing more than the insurance policy itself and it did not consider the Pharmacy Agreement, which is at issue in this case.

It is clear from the record that the Board has never approved the Pharmacy Agreement, and the Division Manager of the Board's Policy Approval Division, a Mr. Pogue, testified that he thought the Pharmacy Agreement was outside of the State's regulatory control. He stated as follows: "I

do not feel that a contract of that nature falls within the jurisdiction of the State Board of Insurance." Plaintiffs argue that the Pharmacy Agreement does not fall within the jurisdiction of the State Board of Insurance simply because it does not constitute the business of insurance.

There is some testimony which contradicts the testimony of Mr. Pogue. A former employee of the State Board of Insurance, a Mr. Connor, gave an arguably contradictory response to what the plaintiffs describe as a "convoluted question" concerning the exemption of Blue Shield's Prescription Drug Insurance Policy form. With respect to this exemption, the following exchange took place between counsel for Blue Shield and Mr. Connor:

> Q. [By Mr. Kaiser] * * * Mr. Connor, at the time of the issuance of this Exemption Order that you are looking at right now, was it your opinion that this particular contract which is marked Deposition Exhibit 52 [the Prescription Drug Insurance Policy], along with the Participating Drug Pharmacy Agreement which Blue Shield proposed to issue, was it your opinion *that that* constituted the business of insurance?
>
> A. [Mr. Connor] Yes.

Plaintiff concedes that one might draw from this exchange that Connor thought the Pharmacy Agreement was a part of the business of insurance. Plaintiffs argue, however, that the phrase "that that" leaves the issue in doubt because Connor may have understood the phrase "that that" to refer only to the policy itself and not to the Pharmacy Agreement. This position is bolstered by Connor's earlier testimony, wherein he stated that he did not recall having occasion to review the Pharmacy Agreement before drafting the Exemption Order and that he had "no recollection of receiving the document."

The testimony of these officials, therefore, at best raises a factual issue concerning the State's position. It, like the 1962 Attorney General's Opinion, is not a definitive statement of the State's position.

The defendants nonetheless place great emphasis on the extent of state regulation and attempt to minimize plaintiff's arguments concerning the "business of insurance." They rely on *Crawford v. American Title Ins. Co.*, 518 F. 2d 217 (5th Cir. 1975), where this court held that pervasive regulation by the State of Alabama over antitrust matters in the insurance industry precluded application of the federal antitrust laws. The problem with the defendants' position is that the McCarran Act applies only when the activity concerned is the business of insurance *and* the activity is regulated by the State. In *Crawford* there was no question that the challenged conduct constituted the business of insurance; rather, the issue was the extent and pervasiveness of state regulation. There seems to be no question that the State of Texas regulates the insurance industry quite vigorously, but there is no similar indication that the activities complained of are considered the business of insurance by the State or by any common sense interpretation of that term.[7]

We recognize that several district courts have rendered decisions contrary to the conclusion we reach today. *Manasen v. California Dental Services*, 424 F. Sup. 657 (N.D. Cal. 1976); *Proctor v. State Farm Mutual Insurance Co.*, 406 F. Supp. 27 (D.D.C. 1975); *Schwartz v. Commonwealth Land Title Insurance Co.*, 374 F. Supp. 564 (E.D. Pa. 1974), sub-

[7] The McCarran Act likewise affords no antitrust exemption to the so-called noninsurance company defendants who are parties to this litigation. Indeed, it would be highly anomalous for this court to conclude that the sale of pharmaceuticals by these defendants constitutes the "business of insurance" for purposes of federal antitrust law.

sequent proceedings reported at 384 F. Supp. 302 (E.D. Pa. 1974); *Nankin Hospital v. Michigan Hospital Service*, 361 F. Supp. 1190 (E.D. Mich. 1973); *California League of Independent Insurance Producers v. Aetna Casualty & Surety Co.*, 175 F. Supp. 857 (N.D. Cal. 1969). Indeed, two such cases have been affirmed on appeal. *Anderson v. Medical Service of the District of Columbia*, 551 F. 2d 304 (4th Cir. 1977); *Frankford Hospital v. Blue Cross*, 554 F. 2d 1253 (3d Cir. May 2, 1977). Perhaps the most far-reaching of these is the *Manasen* case, in which the district court concluded that the McCarran Act exemption applied to a nonprofit corporation engaged in the administration and operation of prepaid dental care programs. The defendant corporation administered prepaid dental care plans under agreements and contracts with various subscriber groups and subscribing purchasers, including governmental bodies, employer organizations, and joint employer-labor trust funds. The subscribers paid periodic premiums to CDS in exchange for future dental services performed for individuals on whose behalf the premiums were paid.

[7] Professional services were performed by practicing dentists who were classified by CDS as "participating" or "nonparticipating" dentists. In order to attain the "participating" status, a dentist was required to look solely to CDS for payment and to set patients' fees at levels not in excess of the amounts established in a CDS approved fee schedule. Any dentist who did not agree to limit his fees to the range specified by CDS would be classified by the corporation as "nonparticipating." Covered patients who selected participating dentists to perform services would receive full benefits under the program. Patients seeking care from nonparticipating dentists, however, would receive less than the full benefits from CDS. The plaintiffs alleged that this arrangement had

the effect of excluding nonparticipating dentists from the CDS market since a CDS patient who sought services from a nonparticipating dentist suffered a financial detriment. Although the defendant corporation was not an insurance company, the court concluded that it was engaged in the business of insurance for McCarran Act purposes. The court placed considerable weight on the favorable impact of the arrangement on the company's insurance rates:

> It is undisputed that the level of dentists' fees are a major factor in determining policy premiums. CDS' payment arrangements to service providers are critical elements in CDS' contractual agreements with its subscribers. These arrangements are intimately related to the interpretation and implementation of CDS' policies and to its reliability as an insurer. Accordingly, the Court finds that the activities challenged in the instant complaint constitute part of the "business of insurance" within the meaning of the McCarran Act.

424 F.Supp. at 666—67 (footnote omitted).

We find ourselves in serious disagreement with the rationale underlying the *Manasen* decision. An activity is not a part of the business of insurance solely because it has an impact, favorable or otherwise, upon premiums charged by the insurer. Monopolistic or coercive activities in "provider industries" may often have a favorable economic impact upon the rates or the costs of insurance companies. But such practices do not become clothed with McCarran Act protection simply because an insurance company has contracted to pay the provider for products or services.

In *SEC v. Nat'l Securities Inc., supra*, the Supreme Court held that the activity of two insurance companies in merging did not constitute the business of insurance, despite the fact the transaction undoubtedly affected policyholders in terms

of the security of their insurance contracts and the reliability of their insurers. Moreover, business activities of insurance companies not peculiar to the insurance industry are outside the scope of the McCarran Act. *Center Ins. Agency v. Byers*, (N.D. Ill. 1976); *American Family Life Assurance Co. v. Planned Marketing Associates*, 389 F. Supp. 1141 (E.D. Va. 1974); *American General Ins. Co. v. FTC*, 359 F. Supp. 887 (S.D. Tex. 1973), *aff'd* 496 F. 2d 197 (5th Cir. 1974). As indicated by the activities of the noninsurance company in *Manasen, supra*, the activity complained of by plaintiffs is not peculiar to the insurance industry. To be sure, price fixing and coercion induced by firms with superior bargaining power are often found in all industries. Thus, Blue Shield's attempts to control costs in the pharmaceutical industry might just as easily be undertaken by a noninsurance firm attempting to meet a contractual obligation to deliver drugs to a wholesale or retail purchaser.

Manasen and other cases have emphasized the favorable impact that price fixing and coercion have had on insurance premiums and the "reliability" of the insurers. It is conceivable that the public might benefit from price fixing arrangements as long as the parties to the arrangement agree to keep prices below free market levels. The Congress, however, has foreseen that the power to fix prices might not always be beneficially administered by those parties holding the power once their competition has been put out of business. It is quite clear that competitors can be destroyed by those whose financial resources permit them to reduce prices until their competition is eliminated, only for the purpose of raising prices in the long run. Whether such economic coercion is proper is not for a court to decide. It is a matter of national policy which has been addressed by the Congress, from which any change will originate only after appropriate

investigation, hearings and deliberation. We apply the law as presently determined by the Congress and we hold that the antitrust laws are applicable to the arrangements challenged herein.

We conclude, therefore, that Blue Shield's Pharmacy Agreement is not a part of the business of insurance and is not shielded from antitrust scrutiny even though it may have some effect upon the company's policyholders and rates.

REVERSED.